NOTE

This Microfiche meets the quality requirements of the American National Standard for Microfiche of Documents (ANSI PH5.9-1975). However, because of imperfections in the document from which it was made, it contains images that are illegible or difficult to read. The source document for this microfiche is the best copy that could be obtained prior to filming.

CIS

Congressional Information Service,
Washington, D.C.

S. Hrg. 100-971

AIRLINE COMPUTER RESERVATION SYSTEMS

HEARING

BEFORE THE

SUBCOMMITTEE ON ANTITRUST,
MONOPOLIES AND BUSINESS RIGHTS

OF THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

THE COMPETITION BETWEEN THE AIRLINE-OWNED COMPUTER
RESERVATION SYSTEMS (CRS)

DECEMBER 10, 1987

Serial No. J-100-46

Printed for the use of the Committee on the Judiciary

U.S. GOVERNMENT PRINTING OFFICE
92-446 WASHINGTON : 1989

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

5521-14.

92-446 0 - 89 - 1

COMMITTEE ON THE JUDICIARY

JOSEPH R. BIDEN, Jr., Delaware, *Chairman*

EDWARD M. KENNEDY, Massachusetts
ROBERT C. BYRD, West Virginia
HOWARD M. METZENBAUM, Ohio
DENNIS DECONCINI, Arizona
PATRICK J. LEAHY, Vermont
HOWELL HELFIN, Alabama
PAUL SIMON, Illinois

STROM THURMOND, South Carolina
ORRIN G. HATCH, Utah
ALAN K. SIMPSON, Wyoming
CHARLES E. GRASSLEY, Iowa
ARLEN SPECTER, Pennsylvania
GORDON J. HUMPHREY, New Hampshire

Mark H. Gitenstein, *Chief Counsel*
Diana Huffman, *Staff Director*
Dennis W. Shedd, *Minority Chief Counsel*

Subcommittee on Antitrust, Monopolies and Business Rights

HOWARD M. METZENBAUM, Ohio, *Chairman*

DENNIS DECONCINI, Arizona
HOWELL HEFLIN, Alabama
PAUL SIMON, Illinois
EDWARD M. KENNEDY, Massachusetts

STROM THURMOND, South Carolina
ARLEN SPECTER, Pennsylvania
GORDON J. HUMPHREY, New Hampshire
ORRIN G. HATCH, Utah

Eddie Correia, *Chief Counsel and Staff Director*
Kenneth G. Starling, *Minority Chief Counsel*

CONTENTS

STATEMENTS OF SENATORS

Page
Metzenbaum, Howard M. (chairman of subcommittee) 1
Hatch, Orrin G 3
Thurmond, Strom 3
DeConcini, Dennis 154

CHRONOLOGICAL LIST OF WITNESSES

Panel consisting of Michael A. Buckman, President, Sabre Travel Information Network, American Airlines, Dallas, TX; Barry A. Kotar, President, Covia Corp., United Air Lines, Inc., Chicago, IL; and Richard E. Murray, President, SystemOne Corp., Texas Air Corp., Houston, TX 4
Scocozza, Matthew V., Assistant Secretary for Policy and International Affairs, U.S. Department of Transportation 139
Panel consisting of A.B. Magary, Executive Vice President for Marketing, Northwest Airlines, Minneapolis, MN; Edward R. Beauvais, Chairman of the Board, America West Airlines, Inc., Tempe, AZ; and Michael E. Levine, General George Rogers Clark Professor of Management, Yale University, New Haven, CT 157
Panel consisting of Carl L. Bryant, President, Mid-America Chapter, American Society of Travel Agents, Columbus, OH, and David A. Swankin, Consumer Federation of America, Washington, DC 253

ALPHABETICAL LISTING AND MATERIAL SUBMITTED

Beauvais, Edward R.:
  Testimony 180
  Prepared statement with appendix 181
Bryant, Carl L.:
  Testimony 253
  Prepared statement 255
Buckman, Michael A.:
  Testimony 4
  Prepared statement 6
  Supplemental statement with attachments 40
Kotar, Barry A.:
  Testimony 61
  Prepared statement 63
Levine, Michael E.:
  Testimony 206
  Prepared statement 209
  "Airline Competition in Deregulated Markets: Theory, Firm Strategy, and Public Policy," Yale Journal article 221
Magary, A.B.:
  Testimony 157
  Prepared statement 160
Metzenbaum, Howard M.: Prepared statement of Delta Airlines, Inc 285
Murray, Richard E.:
  Testimony 88
  Prepared statement with exhibits 90
Scocozza, Matthew V.:
  Testimony 139
  Prepared statement 141

Page
Swankin, David A.:
    Testimony 265
    Prepared statement 267
    "Scams in the Sky," ICRI white paper 279

APPENDIX

Statement of the International Foundation of Airline Passengers Associations, with attachment 291

AIRLINE COMPUTER RESERVATION SYSTEMS

THURSDAY, DECEMBER 10, 1987

U.S. SENATE,
SUBCOMMITTEE ON ANTITRUST, MONOPOLIES
AND BUSINESS RIGHTS,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The subcommittee met, pursuant to call, at 9:43 a.m., in room SD-226, Dirksen Senate Office Building, Hon. Howard M. Metzenbaum (chairman of the subcommittee) presiding.

Also present: Senators Thurmond, Humphrey, and DeConcini.

OPENING STATEMENT OF SENATOR HOWARD M. METZENBAUM

Senator METZENBAUM. The subcommittee will come to order.

Today's hearing continues this subcommittee's examination of the state of competition and consumer protection in the airline industry. Earlier this year, we examined airline mergers, declining customer service, and other effects of deregulation. Today, we examine an issue of profound significance: The impact of airline ownership of computer reservation systems (CRS) on airline competition and consumers.

Many believe that computer reservation systems are the dominant influence in the airline industry today—the lifeblood of competitive survival and engine of industry consolidation. The chairman of American Airlines, the largest CRS owner, has said American is no longer an airline company—it is an information management company. Other carriers, recognizing the link between CRS ownership and success in a deregulated market, scramble to become "information management companies" themselves.

Despite, or perhaps because of, their phenomenal technological capabilities, airline-owned CRS's may be a potent tool of consumer deception and unfair competition. In this holiday season, therefore, when millions of Americans prepare to fly, it is time for the Senate to examine once again whether the CRS market operates in the best interests of airline competition and the consumer.

CRS and the travel agents who use them have become indispensable links in the complex world of deregulation. Today, practically all airlines must be listed on and, if possible, own a CRS.

The Department of Justice has found that CRS vendors, particularly American and United, have the power to abuse airline competition and consumers, and the government has attempted to curb that power.

In 1984, the Civil Aeronautics Board issued a rule banning certain anticompetitive or deceptive practices by CRS vendors. These included "flight display bias," discriminatory booking fees, one-sided contracts with travel agents, and misuse of valuable marketing "intelligence" generated by their systems.

Nevertheless, questions remain about the efficacy of the present or of any CRS regulation:

First, can regulation really prevent airline-owned CRS vendors from favoring their flights at the expense of ones the consumers may actually prefer?

Two, is the average consumer on notice that the system is not neutral?

Three, are captive non-CRS carriers now paying monopoly CRS booking fees to their competitors?

Four, do CRS vendors make it impossible for travel agents to switch systems, even if it would be better for them and their customers?

Five, can any system of regulation, no matter how air-tight, effectively prevent airline-owned CRS vendors from abusing their market power? If not, is divestiture the only true solution?

I am aware that this ground has been plowed before and I harbor no illusions that clear answers to a complex problem will emerge from this hearing. What is clear, however, is that the debate rages on and that diverse opinion exists on what, if anything, should be done.

I have asked our witnesses to focus on what appear to be the most significant issues in this debate, and I look forward to learning a great deal from them today.

The Chair wants to make it clear that there is a problem. Anyone who denies that there is a problem is only kidding themselves and not being willing to accept the facts. Now, there are different ways that problems in this country get solved.

Sometimes they are solved by people who recognize the problem and do something about it. Sometimes they are solved when Congress moves in and passes legislation. It is my opinion that, normally speaking, a congressional approach is not the best approach, because I can think of many instances in the past when legislation has been enacted, not particularly in connection with this subject or anything similar thereto, where the pendulum swings far too great a distance one way or the other when Congress moves to enact a piece of legislation.

I would hope that the hearings today would provide a forum in which the issues can be explored and conceivably thereafter we might be able to find some way to negotiate or bring about a solution to the problem without the necessity of passing legislation.

But absent the ability to bring about some solution, I can say with certainty that a legislative approach will be followed. The specifics of such a legislative approach I do not have in mind, but suffice it to say that when there is a problem you can always find a way to draft a bill to deal with the problem, but it is not always the best way.

Our first panel today consists of Michael A. Buckman, President of SABRE Travel Information Network, American Air-lines, Dallas, Texas; Barry Kotar, President, Covia Corporation, United Airlines, Chicago, Illinois; and Richard E. Murray, President and CEO, SystemOne Corporation, Houston, Texas.

The rules of the committee, this committee, at least, provide that we have a 5-minute limit with respect to statements of the witnesses.

We will be very happy to hear from you, Mr. Buckman. We will be happy to put your entire statement in the record.

But, before you begin, I wish to place prepared statements by Senators Hatch and Thurmond in the record.

[Prepared statements follow:]

PREPARED STATEMENT OF SENATOR ORRIN G. HATCH

Mr. Chairman, thank you for holding this hearing on the competition between the airline-owned computer reservation systems (CRS). This is an important issue that warrants careful analysis. Given the usefulness and competitive advantage of the up-to-date information on air fares, scheduling, seat availability, etc. that the CRS services provide the airline industry, the effect of these systems on competition in the airline industry is of critical importance.

The value of the CRS systems to the airline industry is unquestioned. However, it is also clear that these systems have been used in the past to adversely impact airline competition. At this time it is useful to explore the effectiveness of the Civil Aeronautics Board rules adopted to prohibit the CRS vendors from using their systems in an anticompetitive manner. In November of 1984 a variety of CAB rules became effective applicable to bias and pricing of CRS services. The rule required that "primary" displays be unbiased and they regulated subscriber contracts, the distribution of marketing information and the sale of "service enhancements" to other carriers. Moreover, the CAB imposed a pricing rule that required a carrier-owned CRS to charge all carriers the same access fee.

The Department of Transportation study will be helpful in our examination of this issue and I regret that it is not yet completed at this time. Certainly, the distinguished witnesses here this morning will contribute to our understanding of the impact of competition between CRS systems and I join in welcoming you here this morning.

PREPARED STATEMENT OF SENATOR STROM THURMOND

Mr. Chairman, these hearings are being held to look into the various competitive problems which may exist in the airline computer reservation system industry. There are five major computer reservation systems: Sabre for American Airlines; Apollo for United; System One for the Texas Air group; PARS for TWA and Northwest; and DATAS II for Delta. Moreover, the CRS industry appears to be very competitive with the number of travel agencies and the number of installed terminals increasing monthly. According to the December 10th issue of Travel Weekly, the number of installed agencies has grown by 4.2% since last April, while the number of terminals grew by 16.5%.

The issues which I am particularly interested in hearing about, and which the Subcommittee is pursuing, are those concerning: 1) the booking practices of travel agents which use computer reservation systems; 2) the booking fees charged by CRS vendors to participating carriers; 3) the existence and extent of barriers to entry in the CRS industy, including the use of liquidated damages and rollover provisions in lease contracts; 4) the relationship of the computer reservation system to market dominance in the airline industry; and, 5) the issue of divestiture of CRSs from airline carriers. In addition, I am interested in hearing the views of these witnesses as to the best means of correcting any problems; whether legislation is necessary, whether DOT regulation is the answer, or whether the problem will correct itself through litigation and the courts. In that connection, I should point out that DOT is in the process of investigating some of these very issues, and should have a report sometime early next year. That report should include recommendations as to the necessity for additional regulations.

Mr. Chairman, although the list of issues is quite lengthy, we have a very distinguished and capable panel of witnesses. I have no doubt that these witnesses will provide some very interesting insights into our deliberations, and I want to thank them in advance for their time and effort.

A PANEL CONSISTING OF MICHAEL A. BUCKMAN, PRESIDENT, SABRE TRAVEL INFORMATION NETWORK, AMERICAN AIRLINES, DALLAS, TX; BARRY A. KOTAR, PRESIDENT, COVIA CORP., UNITED AIR LINES, INC., CHICAGO, IL; AND RICHARD E. MURRAY, PRESIDENT, SYSTEMONE CORP., TEXAS AIR CORP., HOUSTON, TX

Mr. Buckman. Thank you, and good morning, Senator Metzenbaum. My name is Mike Buckman, and I am the President of the SABRE Travel Information Network Division of American Airlines.

Senator Metzenbaum. Would you pull the mike a little closer to you, please?

Mr. Buckman. Yes, sir. Is that better?

You have my written statement, which I will endeavor to summarize in the limited time available to make the major points and statements of that document.

American Airlines understands that the purpose of this hearing is to review the current state of competition in the computerized reservation system industry. We welcome the opportunity to discuss our business with you, particularly because there has been so much misinformation provided by the airlines that lacked American's foresight in developing a CRS.

We believe that the CRS rules adopted by the CAB in 1984 create a framework which has allowed both travel agents and airlines to benefit from the continued development of CRS, while allowing vendors the opportunity to reap the benefits of their innovation and investment in this important new business. We do not believe that there is any need for legislation, and I agree with you in this area, that a congressional solution may not be the best approach given that the Department of Transportation is in the midst of an extensive evaluation of all aspects of the CRS rules.

These rules which American supported in the rulemaking proceeding, have had the desired results of establishing CRS as a neutral source of information about air transportation and other travel products, and of increasing competition in the CRS business.

Competition for travel agent locations is now extremely intense, with five strong CRS vendors in the marketplace. At the same time, CRS has continued to provide important benefits to air carriers, and has allowed travel agents and airlines to handle the reservation and ticketing transactions at much greater volume and at far lower costs than they could possibly achieve by any other means. These efficiencies have resulted in benefits to the consumer, both through a wider choice of flights and lower fares.

American supported the elimination of bias, and American has fully complied with the CRS rules. Bias has been eliminated and uniform booking fees have been established at levels below those that American was previously charging the new participants in the system, but above those charged to the earliest participants. This was a necessary consequence of the transformation to uniform fees.

We believe that our current fees are eminently fair prices for the substantial marketing and transactional benefit offered carriers. They result in a fair return to American for the enormous investment, commitment and imagination that went into the development of SABRE. However, we are quite confident that the booking fee level is well below the cost that carriers would incur if they handled this transaction themselves.

Unfortunately, one major vendor has not fully complied with the CRS rules, and this has led to a bitter confrontation in the CRS marketplace. Texas Air Corp., the country's largest carrier, has engaged in improper conduct to force its way into a larger share of the CRS business, tieing overrides to SystemOne and in one case even loaning an agent $2 million on the condition that he buy other agencies and convert them to SystemOne.

In the third quarter of 1987, Texas Air was 28.3 percent larger than American in terms of revenue passenger miles, and 31.9 percent larger in terms of available seat miles. Texas Air has chosen not to compete solely on the merits of the CRS system, but on the basis of air transportation related matters. Thus, it has taken several actions that we have detailed in the documents we have submitted, violating the letter and spirit of the CRS rules.

Texas Air's actions have forced some other vendors to adopt similar policies, and has resulted in a CRS marketplace in which agencies demand overrides of other vendors to match Texas Air's proposals.

In justification of these actions, Texas Air has made the absurd claim in our mind that a 5-year contract, which is the normal term of many contracts in numerous industries, are somehow an unlawful attempt to monopolize the CRS business.

Since American's share of CRS locations has declined from about 43 percent to 37 percent in the last 3 years, we can hardly be accused of monopolizing the CRS business. Moreover, the CAB examined the justification for contracts of various lengths in the rulemaking proceeding, and adopted a rule specifically allowing a 5-year term.

None of these contract provisions impede entry into the CRS business. This is demonstrated by the growth of SystemOne over the last year, despite the existence of these clauses. There is ample opportunity for all vendors to compete at the time a travel agent makes his initial automation decision.

Senator **Metzenbaum**. Could you wind up, please?

Mr. **Buckman**. Yes.

The existence of five major vendors, with the largest having no more than 37 percent market share makes it inherently incredible that such a contract clause could be used to gain monopoly power. As evidenced in the response that we have provided to the committee's questions, this business is a very competitive and rapidly changing industry. We at American have strived to provide a superior product to our customers, justifying their support and our success in this business.

We strongly believe that we have complied consistently with rules set out by the CAB and DOT in competing in this business and this market.

I will be pleased to clarify any of my responses to questions raised by the committee and respond to any other comments you might have.

Thank you very much.

[The statement of Mr. Buckman follows:]

TESTIMONY
of
MICHAEL A. BUCKMAN
PRESIDENT
SABRE TRAVEL INFORMATION NETWORK

My name is Michael A. Buckman, and I am President of SABRE Travel Information Network, a division of American Airlines. American understands that the purpose of this hearing is to review the current state of competition in the computerized reservation system industry. We welcome the opportunity to discuss our business with you, particularly because there has been so much misinformation provided by airlines that lacked American's foresight in developing a computerized reservation system. We believe that the CRS rules adopted by the CAB in 1984 create a framework which has allowed both travel agents and airlines to benefit from the continued development of CRS, while allowing vendors the opportunity to reap the benefits of their innovation and investment in this important new business. We do not believe that there is any need for either further regulation by DOT or legislation by Congress in this area.

The CRS rules, which American supported in the rulemaking proceeding, have had the desired results of establishing CRS as neutral sources of information about air transportation, and of increasing competition in the CRS business. Competition for travel agent locations is now extremely intense, with five strong CRS vendors in the marketplace. At the same time, CRS has continued to provide important benefits to air carriers, and has allowed travel agents and airlines to handle the reservation and ticketing transaction at far lower costs than they could possibly achieve by any other means. These efficiencies have resulted in benefits to the consumer, both through a wider choice of flights, and through lower prices.

The only major problem at the present time is that the CRS rule which precludes tying, or conditioning any air transportation benefit on possession of a particular CRS, is not being observed by this country's largest carrier. Texas Air Corp, which controls almost 20% of the total air transportation service in the United States, but which is a latecomer to the CRS business, is using its airline influence to entice or force travel agents to breach existing contracts with other vendors. American believes these anticompetitive actions of Texas Air Corp could be limited if the DOT were to enforce the CRS rules against tying of air transportation and CRS systems. I will discuss the Texas Air Corp situation in detail further in my testimony, but I will first review quickly the benefits of computerized reservation systems and the current highly competitive marketplace.

I. SABRE HAS PROVIDED SUBSTANTIAL BENEFIT TO BOTH TRAVEL AGENTS AND CONSUMERS.

American's SABRE system is one of the outstanding technological successes of the last decade and one of the great success stories of the modern free enterprise system.

In 1975, American led the effort to create a single industry system because we recognized the tremendous effort and expense that would be involved in computerizing travel agents. Other carriers were unwilling to commit resources to the joint effort, and it died because they lacked the foresight to understand the impact it would have on our industry. However, in response to United's announced plan to offer its own system, American quickly offered its SABRE system and ultimately invested more than $350 million in the effort. Other carriers invested in other methods of competition, such as fancy terminals, or new aircraft, or diversified into other industries. For the past several years, carriers that chose to invest their resources elsewhere have been attempting to use the legislative process and the courts to deprive American of the fruits of its CRS success.

SABRE serves an extremely important function in the deregulated air transportation system - improving buyer productivity. By making it easier for the consumer and the travel agent to examine service alternatives, and complete their booking and ticketing transactions, SABRE improved the efficiency of the distribution of American's own product and the product of other airlines. Because it became so easy to buy tickets through travel agents, the share of tickets sold by agents rose from about 40% of total airline sales in the mid-1970s to over 75% in the mid-1980s.

I should note that the ability to purchase a ticket conveniently is just as important an element of air transportation service as elements such as seat width or meal service. Some of our competitors have argued that competition should be limited to traditional on-board service elements, but this, of course, is simply a failure to recognize the full dimensions of the air transportation experience. Since these carriers failed to recognize the importance of the purchase transaction in the late 1970s, they are simply trying to handicap those that had superior insights.

It is also noteworthy that, without CRS, it is unlikely that consumers would have achieved as much benefit from deregulation as they did. By having flights and fares of all carriers immediately available in CRSs, travel agents were able to offer the widest variety of prices and services to the passenger. In addition, airlines benefited because their product was instantly on the travel agent's "shelf" whenever they entered a new market. Prior to the development of automation, they would have had to undertake expensive advertising and promotional campaigns at significant risk to achieve the same exposure.

Indeed, CRSs have been a major factor in facilitating the success of all parties in deregulation. Just think of the difficulties that would exist in handling the explosion of information created by deregulation without computerization. For example, we load 400,000 new fares in SABRE every night. Manual processing by travel agents of such information would have been impossible at any cost remotely approaching that of CRS.

II. THE CAB RULEMAKING RESOLVED THE COMPETITIVE ISSUES RAISED BY CRS.

Since CRS was a new and important advantage for the carriers who had chosen to develop it, carriers who had emphasized other aspects of competition complained to the government. Most of the criticism is based on the old regulatory attitude that government should control the competitive process in order to protest smaller carriers from the competition of the larger airlines.

Since the criticism focused on preference in schedule displays and differences in booking fees to various carriers, the CAB adopted regulations requiring equal treatment of the flights of all carriers, and non-discriminatory pricing. In addition, in order to preserve competition in the CRS business, it adopted rules forbidding vendors from limiting benefits in air transportation, such as override commissions, to agents who possessed that vendor's CRS, and also limited contracts to a maximum term of five years. American supported adoption of the rules. We supported elimination of bias because we recognized that while we would lose the limited preference for American's flights in our own system, we would gain in the displays of all other CRS vendors. We also had no objection to non-discriminatory pricing.

Once the rules were adopted, American fully complied with them. Bias was eliminated in the primary display, and a uniform booking fee of $1.75 was established. This was below the level that American was previously charging to new participants in its system, but substantially above the price charged to the earliest participants, who had supported the marketing of SABRE through our Cohost program. The booking fee has engendered substantial controversy and meritless antitrust suits from American's competitors. Our response is that the current booking fee is an eminently fair price for the substantial marketing and transactional benefit offered to carriers, and that it is a fair return to American for the enormous investment, commitment and imagination that went into the development of SABRE. However, we are quite confident that the booking fee level is well below the cost that carriers would incur if they handled the transaction themselves.

Recently, for the first time in three years American has increased the booking fee by 10 cents because it has been faced with the same cost and competitive pressures in the CRS business that have affected all CRS vendors. Four out of the five vendors have modestly raised price increases this fall, and American followed

Eastern and United in taking such increases. Subsequently, TWA has also raised its booking fee to $1.85.

Unfortunately, one major vendor has not fully complied with CRS rules, and this has led to bitter confrontation in the CRS marketplace. Texas Air Corp, the country's largest carrier, has engaged in improper conduct to force its way into a larger share of the CRS business. In the third quarter of 1987, Texas Air was 28.3% larger than American in terms of revenue passenger miles, and 31.9% larger in terms of available seat miles. Texas Air has chosen not to compete on the merits of its SODA CRS system, but on the basis of air transportation related matters. Thus, it has taken several actions violating the letter and the spirit of the CRS rules.

- It has threatened travel agents who refuse to convert from SABRE to SODA with the loss of overrides and with the loss of other normal travel agent benefits such as free trips.

- It has made special discount fares available only to SODA agents, and has refused to provide access to this discount inventory to non-SODA agents.

- It has loaned $2 million to one agency to buy other agencies, on the condition that the acquired agencies be converted to SODA.

- It has tortiously interfered with hundreds of existing contracts of other CRS vendors, particularly American, and has indemnified agents against damage caused by their breach of contract.

Texas Air's actions have forced some other vendors to adopt similar policies, and has resulted in a CRS marketplace in which agencies demand overrides of other vendors to match Texas Air Corp's proposals.

In justification of these actions, Texas Air has made the absurd claim that five-year contracts, which are normal term of many contracts in numerous industries, are somehow an unlawful attempt to monopolize the CRS business.

Since American's share of CRS locations has declined from about 43% to 37% or less in the last three years, we can hardly be accused of monopolizing the CRS business. Moreover, the CAB examined the justification for contracts of various lengths in the rulemaking proceeding, and adopted a rule specifically allowing five year contracts.

The falsity of Texas Air's claim that American's actions are a barrier to its entry is demonstrated by its record over the past year. Between September, 1986, and September, 1987, SystemOne grew from 5,300 agencies to 6,828, or 22.3% in one year. More importantly, its CRTs installed grew from 15,499 to 23,293, or 50.2%.[1/] If American is a monopolist that has created barriers to entry, we have done a very poor job! SystemOne's growth suggests that it is Texas Air Corp's tying of CRS to air transportation which is the major issue, and not alleged barriers to entry by American.

RESPONSES TO QUESTIONS RAISED BY SUBCOMMITTEE

With this background I will now address the issues raised at this hearing.

A. Booking Practices.

The marketing data distributed by CRS business vendors seems to show that each vendor continues to get a premium share of sales at travel agencies which it has

---

[1/] Aviation Daily, November 30, 1987, p. 310.

automated. The share preference, usually measured by comparing share of an agency's total sales on a particular carrier with that carrier's share of industry enplanements at the agent's city, has been generally referred to as the "halo" effect of CRS installations.

There are several factors that contribute to halo. It may be that an agency is already predisposed towards a particular airline before he selected the vendor's equipment, and thus halo may be unrelated to the CRS choice. Thus, the agent may prefer the quality of airline service provided by the vendor, and book it in order to satisfy its customers. In addition, the relationship between the vendor and the agent results in numerous contacts between the airline's sales, training and automation personnel and the personnel of the agency. Favorable impressions created by this relationship may result in additional air transportation sales. Another factor is that in the early CRS years, agents had greater confidence of the reliability of the vendor's own data than in the data transmitted through the industry system. (Data reliability is no longer a major issue because most large carriers are connected to CRS systems by direct links, rather than through the industry network.) Finally, agencies often demand override commissions from vendors in order to keep them from converting to other systems, and give the vendor a premium traffic share in response to those overrides.

It should be noted, however, that halo is not dependent on the size of the CRS system, but that it is realized by every vendor. Each vendor gains the same benefit from personal contact with its subscribers and any carrier can pay override commissions. There can be no claim that only the largest CRS vendors gain halo from their relations with travel agents.

Halo does not create adverse competitive or consumer effects. It is certainly a fairer way of gaining a travel agent's confidence than the payment of override commissions, which do nothing but appeal to the agent's financial interest.

The Subcommittee has also asked whether consumers generally know that CRSs are owned by airlines, and whether such facts should be disclosed to travel agent's customers. American believes that many consumers know that CRS systems were created and are owned by airlines. There has been extensive publicity about CRS systems in both the general and the trade press, and travel agents quite normally promote the fact that they use the CRS system of a particular carrier. However, we believe that it would be both impractical and an imposition on travel agents to require that they disclose such an extraneous fact to consumers in the normal reservations transaction. Such a rule would constitute regulation of travel agents for no purpose. Moreover, if travel agents are required to disclose CRS affiliation, they should also disclose the carriers from whom they receive overrides or other incentives.

Finally, the Subcommittee has asked whether display bias continues to exist subsequent to the CAB's rule. American believes that there is no bias in availability displays at the present time. All vendors have adopted objective criteria, not related to any specific carrier, by which to order the display of flights. While there is some variation among the weights given to various factors by different vendors, each vendor is attempting to structure the screen to reflect its concept of consumer preference. Thus, American's SABRE screen is an integrated display of direct and connecting flights, which attempts to place the flights closest to the requested departure time on the first screen. Other vendors may chose to list all direct flights in the city-pair before connections, even though the direct flight may depart several hours later than the requested departure time.

There is still room for manipulation of schedule displays by vendors through failure to load connecting points in a timely manner. American was forced to file an enforcement complaint against Eastern and SystemOne because of the inexplicable failure to load American's Raleigh-Durham hub as a connect point for several months. While Eastern has corrected its practices with respect to Raleigh-Durham, American's complaint is still pending before the Department of Transportation

If any parties to this hearing suggest that there are problems with respect to bias in the present displays, American urges the Subcommittee to require detailed support for such claims. A major problem in the whole CRS debate has been that non-vendor carriers make vague allegations of bias, which vendors cannot rebut because no details are provided. Any claims of post CRS rule bias should be treated with utmost skepticism unless detailed substantiation is provided.

The Subcommittee should also be aware that there is a substantial amount of semantic ambiguity in the way some of the complaining carriers use the term "bias". Bias has historically meant a carrier specific preference factor in the CRS display. It was this bias that the CAB rules eliminated. However, some carriers are now attempting to apply this same term to consumer choice factors represented in the display algorithm. If there are any continuing problems with respect to bias, as that term has been understood prior to the current debate, they are clearly governed by the CRS rules. Any violations of such rules should be handled through enforcement proceedings by the Department of Transportation.

B. Booking Fees.

The Subcommittee has asked whether current booking fee levels harm airline competition, and for evidence to support this claim. The Committee is correct in insisting on evidence because this is another issue on which critics of CRS vendors have engaged in the vaguest of unsubstantiated generalities. Booking fees are only one small element of an airline's cost structure, and are dwarfed in size by other elements such as fuel costs, labor expenses, and travel agent commissions. Any argument that it is booking fees, and not other more significant cost differentiations between carriers, that cause competitive injury is nonsense.

The critics complain however that it is the payment of booking fees to other airlines that is the cause of the competitive injury. Of course, airlines provide services to each other in numerous areas, including ground handling, gate rentals, maintenance work, and aircraft leases. The same criticism could be leveled at any of these cost elements, and there is little reason to single out booking fees. In fact, current booking fees are too low to have any anticompetitive effect on the downstream air transportation market.

Moreover, the current booking fee is less than what it would cost any of these carriers to provide the same service themselves. It costs far more in labor, facility and communications expense to handle a reservation directly than it does through SABRE. Since carriers actually save money when a reservation is made through SABRE, American believes that it cannot be argued the booking fees raise competitors' costs. It is particularly disingenuous for Continental/Eastern to complain about booking fees when it raised its fee to

$1.85 from $1.75 (and in fact averages a price close to $2.10 because most of its bookings are made through its direct access function) rather than through its integrated display.

Since booking fees are not anticompetitive, there is no problem that needs to be remedied by either litigation, regulation, or legislation. Any price regulation would turn CRS systems into public utilities, with all the loss of efficiency and innovation associated with those industries.

C. Barriers to Entry.

There have been loud complaints from other carriers that American's expectation that travel agents live up to existing SABRE contracts amount to a barrier to entry. It is alleged that we have created these barriers to entry by using five year contracts, liquidated damage clauses, and "rollover" provisions, under which the addition of equipment created a new five-year term with respect to the entire contract. The rollover clauses were an administrative efficiency, but American several months ago advised DOT and Congress that it would no longer use them. The liquidated damage clauses are no more than an efficient way of calculating actual damages. In the absence of liquidated damages, American could still collect the same amount, and in fact more, in terms of actual damages when an agent breaches a contract. Five year terms are a normal contract length in many industries. They do not amount to a barrier to entry.

At the outset, we should be clear what these contract clauses do not prohibit: they do not preclude an agent from adding equipment of another vendor at any time and they do not limit competition for travel agent business at the beginning of the term of a contract. All that they require is that, once an agent has made a decision with respect to a CRS system, he live up to the terms of his contractual obligation.

American believes it extraordinary that a proposal for adherence to contracts can be considered anticompetitive. Just think how this airline debate would sound if applied to any other industry. Let us assume, for example, that a consumer examines all the 1987 model cars and decides on a four-year lease of a new Buick. The price that he negotiates with the Buick dealer is lower than the price for a three-year lease because of the dealer's expectation that the payments will be made over the full term of the contract. Let us assume that, a year later, the consumer examines all the 1988 cars and decides that he likes the new Mercury better than his existing one-year old Buick. Let us even assume that the Mercury dealer offers a lower price than his existing monthly rental for the Buick. Under these circumstances, no rational person would suggest that the existence of the Buick lease is an anticompetitive limitation upon the right of the Mercury dealer to compete. We could even expand the analogy to computer mainframes, apartment houses, or airplanes. It is simply beyond belief that lessees would be allowed to walk away from existing contracts with impunity in the name of competitive freedom.

Yet this is exactly what is proposed in the airline industry. Both five-year terms and liquidated damage clauses have perfectly valid economic justifications. The five-year term reduces the amount of the monthly payment by the purchaser, just as a four-year car lease has a lower monthly payment than a three-year lease. The five-year term is co-extensive with the depreciation period of computer equipment, and a limitation of the maximum contract term to a shorter period could well result in CRS vendors having to take write-downs on computer equipment upon the expiration of agency contracts. Finally, the CAB examined this issue in the rulemaking proceeding and specifically allowed five year contracts. Vendors can hardly be criticized for conforming to the CAB rule.

With respect to the liquidated damage provisions, it is important to remember that the agent is well aware that its price is based in part upon the booking fees which the CRS vendor expects to earn over the life of the contract. If the contract is terminated prematurely, the vendor suffers the loss of those future booking fees during the remaining term of that contract. That loss constitutes damages to American which are a reasonably foreseeable consequence of the breach. Without those booking fees, the price charged to the travel agency would not be compensatory. As a means of recovering the actual damages which would be suffered in the event of a termination, several CRS vendors have included liquidated damage provisions in their agency contracts. These provisions are not a cancellation penalty, but are simply an administratively efficient method of measuring and recovering the actual damages that are suffered by a CRS vendor when the contract is breached.

Since the liquidated damage clause is a shorthand method of collecting such actual damages, they place no undue risk or burden on the travel agent. The formula used by American to calculate damages is reasonable. Indeed it is a conservative estimate and does not include all damages which American would suffer in the event of a breach. For example, the formula excludes revenue which American would receive from bookings for cars, hotels and other products available through SABRE. The clause allows both parties to easily calculate, at the time of entering into the agreement, the amount that would be owed in the event of a breach.

We should also note that there is no basis for travel agent complaints about liquidated damage clauses. If an agent does not like them he has a choice of vendors who do not include such clauses, and compete on that basis. In any event, liquidated damage clauses take nothing away from travel agents, since they merely reflect the actual damages that would be suffered by American if the agent breaches his contract.

None of these contract provisions impede entry into the CRS business. This is demonstrated by the growth of SystemOne in the last year despite the existence of these clauses. There is ample opportunity for all vendors to compete at the time a travel agent makes his initial automation decision. Once that decision is made and a contract is signed, it is not unreasonable or anticompetitive to say the one vendor has won and the other has lost a particular location.

This does not preclude expansion of new entrant vendors. There is plenty of turnover in the travel agent business, with 1,500 or 2,000 agents entering yearly, and the number of dual installations is quite large. More than 750 SABRE-automated agents have CRSs of other vendors in the same location. The existence of five major vendors, with the largest having no more than a 37% market share makes it inherently incredible that such contract clause could be used to gain monopoly power.

The Committee has also asked about the results of possible legislative or regulatory restrictions on contract term or collection of damages. While it is always difficult to predict the results of any regulatory activity, the experience of the past decade has shown that they are often quite different from the expectations of the proponents of the rule. For that reason, we are surprised that organizations such as ASTA support restrictions on contract length when the most likely result will be increased prices to travel agents. Another possibility is higher booking fees to airlines, and a third is reduced competition in the CRS business.

The length of the contract term is clearly an element of price. If one element of the price equation is changed, the equilibrium has to change, with the result that some other aspect of CRS pricing will have to be modified. The current provisions generally allow an efficient CRS vendor to earn a reasonable return on its investment over the life of a five-year contract with the travel agency. A shorter contract term would reduce the expected flow of subscriber and airline booking fees without reducing the amount of the vendor's initial investment required to automate the agency - for example, computer and communications hardware, installation expense, maintenance contracts and subscriber training. This would force the vendor to raise its prices to one or more categories of CRS users.

These higher prices can come either from the air carriers or from travel agents. The current contracts permit the vendor to rely upon a future stream of bookings which have, until now, allowed CRS vendors to charge lower prices to travel agents because of the intense competition. Without the assurance of those future revenues, CRS vendors must collect higher fees directly from subscribers. If CRS competition does not allow the collection of such increased revenue in the form of contract charges to travel agents, the money will have to come from the other side of the equation - booking fees from airlines, hotels and car rental companies.

If comes from neither side, CRS vendors will have reduced revenue and unprofitable operations. Their incentive will then be to cut development of new functions that keep CRS on the cutting edge of technology.

Another possibility is that some of the weaker CRS vendors might be forced to exit the industry. Any rule limiting contract term or restricting collection of damages would, of course, apply equally to all vendors. The existing locations of every vendor, not just American, would be at risk and we suspect that those systems that are functionally superior and have lower costs will be the ones that survive.

D. Incentive Programs.

American is pleased that you have included the subject of incentive programs and override commissions on the agenda for this hearing because such commissions have a far more substantial competitive impact then any aspect of computerized reservation systems. Since overrides are a direct appeal to the agent's financial self-interest, they have a far greater ability to move traffic then any non-financial incentive can possibly have.

It seems incongruous to be concerned about the halo effect of CRS systems when overrides and other incentive payments are a generally accepted competitive device. In fact, one of the first major actions of the CAB under deregulation was to disapprove industry agreements limiting overrides. It is entirely inappropriate to legislate about halo without regulating other means of influencing agents, such as overrides.

In response to the subcommittee's question, we believe that large corporations are well aware of the existence of overrides, particularly because they negotiate with travel agents for rebates of part of the override payment. However, we do not believe that the individual passenger is generally knowledgeable about these payments.

E. Access to Marketing Data.

There is no validity to the charge that CRS vendors have access to marketing, booking, and sales data from their own systems that is not available to any other carrier. After the CAB rules were adopted, American complied with the rules and offered all its marketing data to any carrier that wanted to buy it. The data is provided on a computer tape, and includes essentially all of the information in the passenger name record with respect to every booking made through SABRE. Any carrier can take the data and manipulate it into reports in any format it desires.

We have heard criticism of the form in which American provides the data, but these complaints are based more upon the computer literacy of the person complaining, than upon the deficiencies in American's presentation. People who understand computers appreciate the fact that the data is available on tape in a fixed format, and can be manipulated into any report format through the writing of simple software programs. People who are not computer-literate are untrusting of anything that is not handed to them on a piece of paper. Therefore, they desire the vendors to provide hard-copy reports of the booking data. However, each vendor would have different report formats, and it would be impossible for carriers using the data to merge them in an efficient manner. Provision of raw data in computer-readable format, which allows integration of information from different vendors, and the customizing of reports to the needs of the recipient, is a far superior method of providing massive volumes of information.

American absolutely rejects any claim that we have access to marketing data on a different basis than any other recipient of the data. The process by which American accumulates the data is to dump the day's transactions onto a computer tape every night. This tape is accumulated over the course of the month in American's data processing operation, and is then distributed to American and other carriers on a monthly basis. We have heard complaints that American has "real time" access to this data, in contrast to the access provided to other carriers. Those who use this term usually fail to define it. For example, Professor Levine made such a charge in a recent law review article.[1] However, he totally failed to explain what he meant by "real time."

In the computer business, "real time" refers to a transaction in which there is an input, immediate processing in the computer, and immediate output, which is fast enough to affect subsequent input. Thus, real time is transactional in nature, and is not an environment in which one would conduct analyses, such as a review of marketing data. "Real time" does not mean reading data reports produced through utilization of the monthly tapes on a computer screen rather than a piece of paper. This is called "on-line" access, and we suspect this is all that Professor Levine means. Any carrier can have the same "on-line" access to its data simply by loading the marketing reports that it produces from the vendors' marketing tapes into its own computer.

Access to marketing data on a "real time" basis, as defined above, simply does not exist, and it would be useless if it did. All that access to an individual passenger name record shows is the record of that

---

1/ Levine, Airline Competition in Deregulated Markets: Theory, Firm Strategy, and Public Policy, 4 Yale J. Reg 393, 461.

transaction. It does not provide aggregate data useful to a carrier. For example, it would not show how many people chose a particular fare, or how many passengers were booked by a particular travel agent. There is simply no competitive advantage currently available to vendors with respect to marketing data, and there is no basis for further government regulation.

F. CRS and Airline Market Concentration.

The Committee has asked to what extent competitive forces in the CRS market contributed to increasing concentration in the airline industry and whether ownership of a CRS is essential to entry and competitive survival. We believe that there is a false impression that a CRS is necessary for survival. The only basis for any belief that CRS has led to increased concentration is some of the unsubstantiated statements of Texas Air Corp. when it acquired Eastern. However, most other mergers have not involved CRS systems. For example, in the Northwest/Republic and USAir/PSA/Piedmont mergers none of the carriers had a CRS. I should note that USAir/Piedmont has the best operating margin in the industry, despite the lack of a CRS. In the TWA/Ozark merger, the acquiring carrier already had a CRS system.

Thus, there is certainly no basis for concluding that CRS has been a factor in the transportation industry's concentration.

It is also clear that ownership of a CRS is not essential to entry and competitive survival. In fact, CRS facilitates entry by any carrier because any new schedule is instantly available on CRS screens on an equal basis to flights of carriers that have been in the market for many years. Moreover, since displays are unbiased, a non-CRS vendor gets exactly the same opportunity to sell his flight as the vendor-carrier.

G. Divestiture.

The Committee has also asked for comments on the proposal of some carriers that all vendors be required to divest themselves of their CRS systems. Obviously, we think such a policy would be most unfair to American. The basic principle of the free enterprise system is that the developer of a new and important product is entitled to reap the profit. Since the limited competitive problems created by CRS systems were resolved three years ago, and since we can hardly be accused of monopolization when we have a market share of 37% or less, there is no basis for the drastic remedy of divestiture. But, leaving aside American's direct interest in this issue, we think that for several reasons, divestiture would be poor public policy:

1. Innovation would be reduced - Competition between CRS vendors has resulted in a constant process of product improvement that has benefited the travel agent community and the consumer. These improvements have occurred at such a rapid pace because the owners of CRS systems realized that the CRS systems are ancillary to the air transportation business. Because of the linkage between the airline and the CRS business, carriers are quick to recognize the need for new services, and to refine their CRS systems to meet the requirements of travel agents. A non-airline owner would not have the expertise in the airline business to recognize as quickly as has American the desirability of many of the special enhancements that have been added to SABRE.

2. Prices would increase - For at least two reasons, CRS divestiture would result in higher booking fees. For one thing, a purchaser of SABRE would have to earn an adequate return on its investment. It would be required to capitalize - and then recover - the present

value of the system's future profitability. While prices to travel agents may be reduced because vendors compete for halo, the new CRS owners will have no similar incentives. The result will be higher prices to travel agents.

In addition, the integrated operation of both computerized reservation systems for travel agents and internal reservation services for the airline's own operations results in increased efficiency and reduced costs. For example, both services utilize the same communications network, and many of the same service enhancements. These economies of scope result in lower costs for travel agents, and lower booking fees for carriers. As the Federal Trade Commission has explained:

> Economies of scope refer to the instances where one firm can produce two or more products more cheaply than if each product were produced by a separate firm. In other words, it may be more efficient for one firm to engage in air transportation and CRS services than it would be for two separate firms to provide the services. In fact, this may be why CRSs were initially developed by airlines: airlines needed computer services for their own use and, having developed those systems, the larger airlines began to provide services to smaller airlines and were in a position to provide CRSs to travel agents at lower costs than a firm that had no need to develop similar software." (FTC Comments, CAB Docket 41686, November 17, 1983, p. 28.)

3. Bias would return - Divestiture would also restore the completely unregulated environment that existed prior to the adoption of the CRS rules, which apply only to CRS systems owned by airlines. If the system were sold to a non-airline, the new CRS owner would have every economic reason to reinstate bias as a means of increasing charges to its customer airlines. It could, and certainly would, sell a favored display position for a higher price. Although it may be suggested that Congress or the DOT could forbid the sale of preference in non-airline systems, there are constitutional problems with this approach. To the extent that CRS systems are advertising media just like newspapers, they are protected by the First Amendment right of commercial free speech. Indeed, a public interest group has filed an appeal of the current DOT rules on display of on-time performance in CRS systems in the D.C. Circuit, raising exactly this issue. Thus, divestiture would, in all likelihood, eliminate the neutrality of the current CRS displays.

Conclusion

As we have shown above, the CRS business is highly competitive and the complaints of the other vendors are incorrect. We hope that the DOT report will resolve the issues of Texas Air Corp's use of its air transportation position to gain CRS business. Other than requiring compliance with the CRS rules, however, we do not believe there is any need for further Congressional or regulatory action.

38770

SABRE
Travel Information Network

January 12, 1988

The Honorable Howard Metzenbaum
Chairman, Subcommittee on Antitrust Monopolies
and Business Rights
Committee on the Judiciary
United States Senate
Room 140-Senate Russell Builldİng
Washington, D.C. 20501

Dear Senator Metzenbaum:

American appreciates the opportunity to supplement the record of the hearing before your Subcommittee on airline computer reservation systems.

As pointed out in my direct testimony, much of the criticism of the CRS vendors is based upon undocumented generalities. We, therefore, urged the Committee to require detailed, factual support for allegations of wrongdoing. Notwithstanding our request, most of the criticism at the hearing was, again, unsubstantiated and, where factual data was offered, it was frequently incorrect. Time does not permit a detailed response to each point raised by witnesses at the hearing, most of which were rebutted in my written testimony. However, I hope that the following information will correct some of the more egregious misstatements.

1. Witnesses for both Northwest and America West claim that current booking fee levels are excessive, compared to the costs of the CRS vendors. Mr. Magary offered to provide to you a study by Simat, Helliesen & Eichner, prepared in 1985, which alleged that the cost per booking for United was about 66¢, and the cost per booking for American was about 33¢. The conclusions of that study are clearly incorrect, and for the most part rejected by the General Accounting Office in its report. Indeed, any study concluding that United's unit cost per booking is twice that of American's is, on its face, of dubious validity. In order for you to have a complete record with respect to these allegations, I am enclosing copies of the GAO Report, the rebuttals of American and United to the SH&E study, and the response to the GAO Report filed by American with the Department of Transportation.

More recently, American has provided to the Senate and DOT extensive documentation of its fully allocated cost for SABRE for the period covering 1980-86. American's cost per booking has increased from $1.20 in 1984 to $1.67 in 1986 (Attachment B).

2. Several critics, including representatives of Eastern and Northwest, complained about the current $1.85 booking fee charged by American and United, and suggested that the level of the fee represents some sort of exercise of market power. For representatives of competing CRS systems to complain that these booking fee levels are excessive, without disclosing to the Committee that their own charges are at exactly the same level comes with particularly poor grace. If American's and United's booking fees are excessive, then so are the charges of SystemOne and PARS. The fact that booking fees for all CRS vendors are at the same level indicates both that booking fees are set on a competitive basis and that they are reasonably related to costs. A history of the booking fees established by each vendor since adoption of the CRS rules clearly shows that booking fees behave just like prices in other competitive markets (Attachment C). Those vendors that originally underpriced their product raised their fees as soon as possible (because of the CRS rules, they were constrained to wait a year before increasing them). Since the original booking fees were established, the same cost pressures have apparently affected all vendors, with the results that in the course of 1987, every vendor increased its booking fees to approximately the same level.

If booking fees actually exceeded costs by a substantial margin, it is highly unlikely that every vendor's booking fee structure would so closely parallel its competitors. Surely, a vendor with substantially lower costs would have reduced its booking fees and encouraged non-vendors to support placement of its CRS system in travel agencies.

While we do not know the costs of the other vendors, we suspect that American's costs are modestly lower than theirs because we have the most efficient system. Therefore, it is American's booking fee level which constrains the higher prices that other vendors might otherwise charge. We should also note that every other vendor had increased booking fees prior to American's recent limited increase.

3. We warned in our testimony that CRS critics would either misuse the term "bias", or make unsubstantiated allegations that bias, even when correctly defined, continues to exist. Mr. Beauvais, of America West, has done both! He suggests that the choice of connecting points by CRS vendors is biased, as is the manner in which flights are edited for display. With respect to the first claim, in the three years since the rules were adopted, American has not received a single complaint that it has unjustifiably excluded another airline's connecting city from SABRE displays. Under the CRS rules, the list of all connect points used in each city-pair is available through a simple CRS entry. SABRE builds schedules over as many as thirty connect points in each city-pair, receiving the list of connect points from the OAG and from participating carriers. Mr. Beauvais has offered no substantiation for any claim that American's practices favor its own flights.

Mr. Beauvais has provided examples of America West connecting flights that have been excluded from the display. However, none of the displays show any anti-competitive purpose, and, in any case, the standards used to include or exclude a flight apply equally to the flights of American and of all other CRS participants.

In any event, American has recently changed its editing procedures to allow more connections to withstand the edit process. This will increase the number of total connecting flights available for display in any particular city-pair. If the total number of flights in the city-pair exceed the 3,110 flight capacity of SABRE's city-pair file, the maximum connect time, which is usually four hours, will be reduced until the total number of connections in the city-pair match the capacity of the computer. We have attached American's report to other carriers of the changes in the editing process (Attachment D).

4. Mr. Murray, of SystemOne, weakly accused American of "playing with the numbers" when we pointed out that SystemOne's growth in locations amounted to 22.3% in one year, and its growth in CRTs amounted to 50.2% during the same period. The fact that Mr. Murray did not rebut our figures substantiates the point that there are enough new entrants and normal turnover in the industry to allow quite healthy growth for new vendors (Tr. 32). So that you have no doubt about the validity of American's numbers, which are taken from speeches by SystemOne officers, I enclose a copy of the Aviation Daily article upon which they are based (Attachment E).

The most recent market share data from Travel Weekly shows that both American and United have been losing market share to other vendors, and effectively rebuts any claim that our contracts constitute barriers to entry by other CRS vendors (Attachment F).

5. In our discussion of marketing data, I offered to provide you with information about when the marketing data became available to other carriers (Tr. 26). American prepares a monthly marketing tape and ships it by Federal Express to purchasers on the same day that it is made available to American's Marketing Department. Any carrier that would like to pick it up on that day is welcome to do so.

6. Finally, we must note the inconsistency between Professor Levine's claim that travel agents would lose credibility if they told customers that their objectivity is not affected by override commissions, and his assertion that his own objectivity is unaffected by his consulting relationship with Texas Air Corp (Tr. 70, 86). Professor Levine testified in a public trial in Denver last year that he is receiving a retainer of $110,000 per year from Texas Air Corp (Attachment G). If Professor Levine sincerely believes that such a large retainer does not undermine his objectivity, we suggest that he has little

license to be critical of travel agents that receive modest commission overrides!

If you have any further questions about CRS matters, we will be glad to meet with you or your staff at any time.

Very truly yours,

Michael A. Buckman

Michael A. Buckman
President

Attachment B

SABRE

Unit Cost per Booking

1984	1.20
1985	1.34
1986	1.43
1987	1.67

Source: SABRE fully allocated costs from 1985 Senate and 1987 DOT submissions divided by total air (including AA), car and hotel bookings.

Attachment C
Page 1

Booking Fee History

Basic Level

	APOLLO	DATAS II	PARS	SABRE	SODA
Dec. 1984	$1.85	$ .75	$1.75	$1.75	$ .75
Dec. 1985		1.25			1.25
Dec. 1986		1.50			1.75
Dec. 1987		1.85[1]	1.85[1]	1.85	1.85

---

[1] Datas II and PARS fees announced in December for February, 1988 effectiveness.

Attachment C
Page 2

Booking Fee History

Supplemental Level
(Total Access or Equivalent)

	APOLLO	DATAS II	PARS	SABRE	SODA
Dec. 1984				$2.00	$1.00
Dec. 1985			$2.00		1.50
Dec. 1986		$1.75[1]			2.00
Dec. 1987	$2.10[2]	2.00	2.10[3]	2.10	2.10

---

[1] Datas II Direct Access created effective June, 1986.

[2] United did not charge for Direct Access prior to October, 1987.

[3] Datas II and PARS fees announced in December for February, 1988 effectiveness.

Attachment D

```
QP HDQZLAA HDQAJAA
.HDQAJAA 292037/90/602H9.
 ATTN PARTICIPATING CARRIER -
 THE FOLLOWING CHANGES WILL BE MADE TO THE SABRE DISPLAY
 PARAMETERS EFFECTIVE DECEMBER 19 1987-
.
 I. OVERLAPPING EDIT /PAGE 5/-
      -------------
      EXISTING EDIT-
      -------------
.
 FLT TO WHICH          OVERLAPPING FLT SUPPRESSED IF
 OVERLAPPING FLT       ELAPSED TIME LONGER BY...
 IS COMPARED
...........................................................
.                         ONLINE CONX        OFFLINE CONX
                          -----------        ------------
                       AT LEAST-            AT LEAST-
 DIRECT FLT      .        35 PERCENT AND  .  35 PERCENT AND
                 .        31 MINUTES      .  31 MINUTES
...........................................................
 ONLINE CONX     .        20 PERCENT      .  ALWAYS
.                .        31 MINUTES      .  SUPPRESSED
...........................................................
 OFFLINE CONX    .        35 PERCENT      .  ALWAYS
                 .        31 MINUTES      .  SUPPRESSED
.
      --------------------------
      EDIT EFFECTIVE DECEMBER 19-
      --------------------------
.
 DIRECT FLT      .        35 PERCENT AND  .  35 PERCENT AND
                 .       181 MINUTES      .  31 MINUTES
.............................................................
 ONLINE CONX     .        20 PERCENT AND  .  ALWAYS
                 .       121 MINUTES      .  SUPPRESSED
.............................................................
 OFFLINE CONX    .        35 PERCENT AND  .  ALWAYS
                 .       121 MINUTES      .  SUPPRESSED
.
.
II. PENALTY ON NON-PARTICIPATING CARRIER FLTS /PAGE 2/-
      ----------------
.     EXISTING PENALTY-
      ----------------
.      120 POINTS /MINUTES/
.
      -----------------------------
      PENALTY EFFECTIVE DECEMBER 19-
      -----------------------------
       720 POINTS /MINUTES/
.
 NOTE- WHEN THE NUMBER OF FLIGHT ITEMS THAT QUALIFY FOR
 DISPLAY EXCEEDS THE CAPACITY OF A CITYPAIR RECORD /3110
 FLIGHT ITEMS/ THE MAXIMUM CONNECT TIME IS DECREASED IN
 30-MINUTE INCREMENTS UNTIL THE NUMBER OF FLIGHT ITEMS
 REACHES 3110. /ONCE THE MAXIMUM CONNECT TIME IS REDUCED
 TO 90 MINUTES AND SYSTEM CAPACITY IS STILL EXCEEDED CMA
 THE INCREMENTS ARE IN 10 MINUTES/. THIS CONSTRAINT CUR-
 RENTLY AFFECTS JUST .07 PERCENT /OR APPROXIMATELY 180/
 OF THE 272000 CITYPAIRS STORED IN SABRE.
.
 WE ANTICIPATE YOU WILL FIND THESE CHANGES POSITIVE. THE
 CHANGE TO THE OVERLAPPING EDIT WILL RESULT IN THE DIS-
 PLAY OF MORE CONNECTING SERVICES. THE INCREASED PENALTY
 POINTS ON NON-PARTICIPANTS WILL PROVIDE GREATER DISPLAY
 OPPORTUNITIES FOR PARTICIPANTS/ SERVICES. A REVISED
 DISPLAY PARAMETERS DOCUMENT WILL SOON BE DISTRIBUTED.
 BRODS/K.TRYFOROS/HDR AIRLINE SALES

29DEC2037
HDC40AA 0383
```

AVIATION DAILY November 30, 1987

NEW SYSTEM ONE FEATURES TO BE INTRODUCED

System One Corp., the computer automation arm of Texas Air, plans to make available a number of new computer reservations system features next year, with most of the products scheduled to be formally introduced early next month and operational in January. The new products, both front and back office, were unveiled during a recent user conference in Denver (DAILY, Nov. 19). Company also announced that, beginning in early January, all new equipment installations at subscriber sites will be units of IBM PS/2, IBM's newest personal computer. Three of the other five domestic CRS vendors already have announced the switch to the PS/2.

System One officials said new versions of Air Planner and Air Auditor also are being developed. Both are currently sold as additions to the basic CRS, but new versions will not carry an extra charge. Air Planner is used for booking and for ranking purchases of air, hotel and car services based on how they adhere to a corporate customer's established travel policies. Air Auditor provides for a review of purchased services after the original booking, but before the trip is actually taken, to ensure that the best value is received. Bookings can be rechecked on demand or as frequently as desired by the agency or customer. Doug Fogwell, marketing director for System One Airplan Services, said the products provide quality control without "tremendous labor costs."

Officials also announced an "enhancement" of the System One Personal Computer product. Product is designed to be user-friendly, decrease the number of booking mistakes and make travel agent training easier and less time-consuming. Functions include simplified transaction formats, fill-in-the blank forms for prompted transactions, color highlighting, assumed inputs, one-time data entry, combined transactions, prompting messages, partitioned screens, pre-edited data input and help functions. With the enhancement, the PC screen is separated into five distinct areas, including two work areas, two status lines and one help-panel area, and is scheduled to be available to System One subscribers in January.

System One Travel Resources announced additions to its Max Systems, intended to extend the benefits of the total automated business management system to medium-sized and smaller travel agencies, according to officials. One of the new products is intended for the IBM System/36 series and is targeted at agencies with revenues of $1.5 million to $17 million annually. For smaller travel agencies with revenues of $500,000 to $3 million, officials announced Maxnet, a PC-based accounting network for financial management. Both new products have many of ~~the~~ same capabilities of the original Max Systems. They make available complete instant access to all current or historical information that appears on invoices, as well as a complete history of invoice payments received, checks disbursed and related vouchers, according to officials. Max Systems for the IBM System/36 does not require the same skills of a systems operator. Maxnet is available on three levels, the first for agencies with sales volumes of under $3 million annually. By adding functionality at additional cost, the second and third levels of service will be available to agencies with sales volumes exceeding $3 million annually. Level one will be available in January, while levels two and three will be available in mid-1988. The Max Systems for IBM System/36 subscribers also will be available in January.

Company officials said at the user conference that between September 1986 and September 1987, System One grew from 5,300 agencies to 6,828 and from 15,499 CRTs to 23,293. Russ Caccamisi, VP-marketing for System One, said the increase can be attributed partially to agency conversions from other vendors, but comes primarily from new subscribers. He said System One is not drawing subscribers away predominantly from any one competing vendor.

AMADEUS ADDS THREE MEMBERS TO MANAGEMENT TEAM

Amadeus, the European computer reservations system being developed by Air France, Iberia, Lufthansa and SAS, has named three new members to its management team. Felipe Gonzalez was named director-corporate and marketing communications. Gonzalez joined Iberia in 1969 and had served as VP-corporate communications before his Amadeus appointment. Bernard Anquez was named director-strategic planning and budget manager, marketing department. Anquez has been responsible for Air France activities in Japan, based in Osaka, since 1983. Hans Jorgensen was named director-airline services. He joined SAS in 1977 and has held several positions with the carrier, most recently manager of distribution systems.

AERONAUTICS Leasing, Golden, Colo., has leased one MD-82 to Northwest to replace the one lost in the Detroit crash earlier this year.

COPYRIGHT © 1987 NEWS AMERICA PUBLISHING, INC

board of directors.

ARTA President Ron

Continued on Page 51, Col. 3

Vendors Sustain Expansion Pace

BY NADINE GODWIN

■ SAN FRANCISCO — U.S. reservations vendors are continuing to increase their numbers of installations in this country and abroad.

The growth rate for installations since last April was about 200 a month. That outpaces the growth of ARC agencies (about 130 a month), suggesting that more retailers are turning to multiple system arrangements.

The statistics were compiled on the eve of Travel Weekly's Focus on Automation conference in San Francisco.

A significant development is the continuing shift in mar-

Continued on Page 4, Col. 3

INSIDE

22 Israel

28 Bahamas

30 Latin Americ

34 Europe

Vendors Continue to Keep Up the Pace of Expansion

Continued from Page 1

ket shares for numbers of agency locations and numbers of CRTs installed by each. Market shares don't change quickly, but the biggest gainer in the latter portion of this year clearly has been PARS.

Another development has been the growth in average number of installations. The number of installed agencies rose 4.2% since April, while the number of CRTs jumped 16.5%.

Stated differently, the average agency office last spring had 3.9 CRTs. By the end of November, that figure had risen to 4.4.

Effective Nov. 30, the vendors reported the following numbers in the U.S.:

- Sabre, 11,787 agencies.
- Apollo, 8,500.
- System One, 6,250.
- PARS, 5,025.
- DATAS II, 3,122.

The CRT counts for the systems are:

- Sabre, 56,354.
- Apollo, 42,000.
- System One, 24,228.
- PARS, 19,023.
- DATAS II, 10,942.

The total number of agency sites is 34,684, whereas the number of ARC locations is about 30,100.

On the premise that about 95% of all outlets (or 28,595) are automated, the excess represents about 21% of all automated sites. That suggests that as many as one in five locations has two systems.

The Nov. 30 statistics, when compared with those gathered by Travel Weekly from vendors in late April, 1987, indicate a PARS share gain of about 2 percentage points for both installations and CRTs. System One's share gain for agency sites in that period was about half a percentage point (0.6%), but for CRTs it was 1.7 points.

The other three vendors lost what PARS and System One gained. In fact, Apollo's agency numbers slipped slightly, although its CRT numbers increased for a better average-size installation. Its share of retail sites dropped 1.3 percentage points while its CRT share dropped three points.

Sabre's share of agencies and of CRTs both declined by one percentage point. The DATAS II shares held almost even, with a 0.1 point drop in agency share and a 0.2 point increase in CRT share.

The current shares for agency locations are: Sabre, 34%; Apollo, 24.5%; System One, 18%; PARS, 14.5%, and DATAS II, 9%.

The current shares for CRT sets are: Sabre, 37%; Apol , 27.5%; System One, 15.9%; PARS, 12.5%, and DATAS II, 7.2%.

The difference between agency and CRT shares reveals a continuing dominanc by Sabre and Apollo amon larger agencies.

Worldwide numbers are a follows: Sabre, 12,477 agencies and 58,814 CRTs Apollo, 9,200 agencies an 43,400 CRTs; System On 6,700 agencie and 25,22 CRTs; PARS, 5,219 agencie and 19,569 CRTs, and DATAS II, 3,232 agencies an 11,226 CRTs.

Attachment F
Page 2

CRS Market Shares

December, 1987

	Locations	CRTs
SABRE	34.0%	36.9%
APOLLO	24.5	27.5
SystemOne	18.0	15.9
PARS	14.5	12.5
DATAS II	9.0	7.2

Source: Travel Weekly.

Attachment G

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Civil Action No. 86-Z-1521

CONTINENTAL AIR LINES, INC.,

Plaintiff,

vs.

UNITED AIRLINES, INC.,

Defendant.

REPORTER'S TRANSCRIPT
(Preliminary Injunction Hearing: Volume I)

Proceedings before the HONORABLE ZITA L. WEINSHIENK, Judge, United States District Court for the District of Colorado, commencing at 11:15 a.m., on the 4th day of August, 1986, in Courtroom C-204, United States Courthouse, Denver, Colorado.

APPEARANCES

MORRISON & FOERSTER, by ROBERT F. HANLEY, ALAN K. PALMER, and JANET C. PERRIMAN, Attorneys at Law, 1670 Broadway, Suite 3100, Denver, Colorado, 80202, appearing for the plaintiff.

DAVIS, GRAHAM & STUBBS, by DAVID M. EBEL, Attorney at Law, 370 17th Street, Suite 4700, P.O. Box 185, Denver, Colorado, 80201, and CHARLES A. MILLER, ROBERT B. OWEN, and CAROLYN F. CORWIN, Attorneys at Law, COVINGTON & BURLING, 1201

THE COURT: You were a proponent, so I can clarify--you were a proponent for deregulation early on?

THE WITNESS: I was and remain one.

BY MR. PALMER:

Q. Do you have any ongoing consulting relationship with Continental or any of its corporate affiliates?

A. Yes. I consult on corporate marketing and strategy and tactics for New York Air and through New York Air really all the components of the Texas Air group, Continental and the parent corporation as well.

Q. Are you testifying here pursuant to that arrangement?

A. No, I am not. I'm testifying here on my own time, may I say, because I feel very strongly that airline deregulation depends on the maintenance of competitive markets places to discipline the carriers who compete, now that the Government has been relieved of that role. And I am very interested to see that a situation as important as the Denver competitive situation not be resolved in a way that gives the policy a bad name.

Q. Professor, I'd like to ask you to state first briefly your conclusions on the issues you've examined; and then we're going to get into the basis for those conclusions.

MR. MILLER: Your Honor, I hope we'll be told what the issues are before we get the conclusions.

THE COURT: I'm sure it will be asked.

carriers that have been in very severe financial trouble that have used such techniques to extend their operating lifetime considerably. And so I assume that those would be available to Frontier.

Q. Could you very quickly give us an example?

A. Yes. For example, Frontier has some aircraft--has a large number of aircraft that are leased. I don't know the terms of the leases, but I know that they were acquired at a time when airplanes cost a lot less than they do today. I assume they might be subleased on terms that would yield some cash.

Frontier has gates at Denver which are not the subject of this agreement. It would be entirely possible to assign them to someone else for a consideration, lease them back, with the person to whom they had been assigned having a right to pick them up in the event that Frontier ceased operating from them and on terms that would make a profit for the person--the airline that advanced the cash. Those would be two examples.

MR. PALMER: Thank you very much, Professor. That's the end of my examination.

THE COURT: Thank you. You didn't use all three minutes, so we'll note that.

All right. Cross, please.

CROSS-EXAMINATION

BY MR. MILLER:

Q. Professor Levine, I'm going to have to be selective in the questions I ask you, although your statements have brought many to mind. And yet I think it is usefule for the Court in evaluating your testimony, which has many conclusions and subjective statements in it, to have a somewhat better appreciation of your relationship with the company on whose behalf you appear today. Could you describe your relationship with the Texas Air family a little more completely?

A. Yes. I'm--as I said in answer to my own counsel, I'm on a retainer arrangement with that--with that group. The actual--my paycheck comes through New York Air, if you will, which is a wholly owned subsidiary of TAC; and I am paid to provide advice on a wide variety of marketing strategic and technical kinds of questions: Should we be in this market, what should we be charging, what should the respective roles of different TAC carriers be in certain markets that one might consider entering or restructuring? What is the competitive environment likely to look like six months or a year from now? Is there any way to get around the influence of C.R.S. systems? What can we do to make sure obviously that we prosper, and what can we do essentially to sell airline seats?

Q. And what is the amount you receive?

A. I'm paid $110,000 a year by those companies for that.

Q. And when you said that you're not being paid anything for your testimony today, you mean nothing in addition to that?

A. I mean that my agreement with them does not cover this sort of activity.

Q. Now, Professor Levine, you have referred on repeated occasions in your statements to United's dominance at the Denver hub. What is the measure by which you conclude that United is dominant at the Denver hub?

A. It has the largest number of departures. It has its hub domination or C.R.S. domination.

Q. Hub dominance?

A. Largest number of departures, largest number of seats, largest number of gates.

Q. Exhibit 2 that you were testifying to from earlier shows that at least in May of 1986, United offered in the 34 markets in question in which it competes with Continental approximately 21,000 seats and that Continental offers approximately 19,000 seats. Is that correct?

A. It's your exhibit, subject to check.

Q. No, as a matter of fact it's your exhibit.

A. Not mine, in any event.

March or May?

Q. Either one. I said May.

A. I'm sorry. In May, Continental's seats were 18,888; United's seats, 21,032.

Q. Do you have any knowledge of what additional seats either United or Continental offer in markets where they do not compete with each other?

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Civil Action No. 86-Z-1521

CONTINENTAL AIR LINES, INC.,

Plaintiff,

vs.

UNITED AIRLINES, INC.,

Defendant.

REPORTER'S TRANSCRIPT
(Hearing on Preliminary Injunction: Bench Ruling)

Proceedings before the HONORABLE ZITA L. WEINSHIENK, Judge, United States District Court for the District of Colorado, commencing at 4:45 p.m., on the 5th day of August, 1986, in Courtroom C-204, United States Courthouse, Denver, Colorado.

APPEARANCES

MORRISON & FOERSTER, by ROBERT F. HANLEY and ALAN K. PALMER, Attorneys at Law, 1670 Broadway, Suite 3100, Denver, Colorado, 80202, appearing for the plaintiff.

DAVIS, GRAHAM & STUBBS, by DAVID M. EBEL, Attorney at Law, 370 17th Street, Suite 4700, P.O. Box 185, Denver, Colorado, 80201, and CHARLES A. MILLER, Attorney at Law, COVINGTON & BURLING, 1201 Pennsylvania Avenue, N.W., P.O. Box 7566, be a violation of law, I don't--I can't just go along with the statement that if that is a violation of law, then, a fortiori, it's a violation of antitrust law to involve another airline in a frequent flyer program or to put them on a computer in a way that is clearly shown that "this is Frontier Airlines" and "this is United Airlines" and in full compliance with the regulations. So there is some very serious question in my mind of whether on this issue, just by the stipulation, Plaintiff carries its burden on the first factor of Lundgrin.

The APOLLO data is very difficult, because it appears without question, even though--even though I'm sure that there is a difference between APOLLO data and Sabre data, based on whether it's the reservations that you're looking to on the APOLLO or the actual use of the Sabre--the difference and the distortion caused by this has not really been adequately explained, although it is clear that--it seems to me that the travel agents that have the APOLLO system book more United flights. I think there is no question about that, in comparison to those that have the Sabre; or to put it in the other way, the comparison was made about Continental, how Continental does with the APOLLO travel agents as opposed to the Sabre travel agents. And certainly the statistics show that Continental does much better with the Sabre people. And this may very well be due to many factors: loyalty of travel agents to United, if they're using the APOLLO, the override and other encouragements; but again, there has been no strong proof to my satisfaction that there are really illegal or improper reasons for this, because what we have is hearsay evidence on the part of Continental, which is not very reliable, and we have a very strong denial on the part of United that these take place.

✓

I think I don't want to talk too much about the synergistic effects; but I thought the testimony of Professor Levine was very interesting and certainly conveyed a point of view. One of the little problems with his testimony and the idea of a synergistic effect is the problem that really he is getting a substantial retainer from the parent corporation or at least an associate of one of the parties.

Altogether, in conclusion on likelihood of prevailing on the merits, I have some serious question whether Plaintiff has sustained its burden on that issue, on that prerequisite.

Irreparable injury: In order for the plaintiff to carry its burden on this point, it must show damages connected with the probable violation of the antitrust laws. Speculative damages are not sufficient; and to the extent that there are going to be damages to Continental, it would appear to me that the evidence is stronger that they may very well be calculable and therefore are not irreparable. We have a lot of statistics, we have a lot before the Court; and I'm sure Continental has more showing what they do. And they can compare what they do

BUYOUT COMPARISON BETWEEN SABRE AND SYSTEM ONE LEASE AGREEMENTS

EXAMPLE NO. 1

ANNUAL REVENUE:	$981,003
CONFIGURATION:	4 CRTs, 2 PRINTERS
CONTRACT MONTHS REMAINING:	42 MONTHS
SEGMENT FEE:	$2.10 PER SEGMENT
MEAN AVERAGE MONTHLY BOOKINGS:	160 SEGMENTS PER CRT

SABRE MAINTENANCE AND USE AGREEMENT

PARAGRAPH 13 - EVENTS OF DEFAULT; CANCELLATION

W.	APPLICABLE CHARGE FOR DISCONNECT OF EQUIPMENT:	$600.00
X.	TOTAL MONTHLY SERVICE CHARGE X MONTHS REMAINING X 80%: $650 X 42 MONS. X .80 =	21,840.00
Y.	MEAN AVERAGE MONTHLY BOOKINGS: 160 SEGMENTS PER CRT X 4 CRTs X 42 MONS. X $2.10 X .80 =	45,158.40
Z.	PROMOTIONAL SUPPORT: $58.895 COMPOUNDED ANNUALLY AT 10% FROM DATE OF RECEIPT OF SUCH SUPPORT =	68,023.73
	***TOTAL LIQUIDATED DAMAGES FOR SABRE CONTRACT:**	**$135,622.13**

*THE AUTOMATIC ROLLOVER OF THE AGREEMENT TERM FOR ADDED EQUIPMENT WOULD INCREASE THE BUYOUT AMOUNT BY A MINIMUM OF: $650 X .80 = $520 (MONTHLY SERVICE CHARGE); PLUS 160 SEGS. X 4 CRTS X $2.10 X .80 = $1,075 (SEGMENT FEES) FOR A TOTAL OF $1,595 FOR EACH ADDITIONAL MONTH INSTALLED.

SYSTEM ONE DIRECT ACCESS LEASE AGREEMENT

PARAGRAPH 14 - EVENTS OF DEFAULT; CANCELLATION

1)	TOTAL MONTHLY LEASE CHARGE X MONTHS REMAINING: $1,105 X 42 MONS. =	$46,410.00
2)	REIMBURSEMENT FOR FREE MONTHS: 6 FREE MONTHS (ON AVERAGE) X $1,105 =	6,630.00
3)	EQUIPMENT REMOVAL CHARGE:	$750.00
	TOTAL LIQUIDATED DAMAGES FOR SYSTEM ONE CONTRACT:	**$53,790.00**

BUYOUT COMPARISON BETWEEN APOLLO AND SYSTEM ONE LEASE AGREEMENTS

EXAMPLE NO. 2

ANNUAL REVENUE:	$865,449
CONFIGURATION:	4 CRTs, 2 PRINTERS
CONTRACT MONTHS REMAINING:	42 MONTHS
SEGMENT FEE:	$2.10 PER SEGMENT
MEAN AVERAGE MONTHLY BOOKINGS:	150 SEGMENTS PER CRT

APOLLO RESERVATIONS AND TICKETING SERVICE SUBSCRIBER LEASE AGREEMENT	
PARAGRAPH 22 - LIQUIDATED DAMAGES	
A. MONTHLY FIXED CHARGE X MONTHS REMAINING X 80%	
$865 X 42 MOS. X .80 =	$29,064.00
EQUIPMENT REMOVAL CHARGE =	660.00
SUBTOTAL =	29,724.00
B. VARIABLE CHARGES (AVERAGE):	2,536.16
C. MONTHLY MINIMUM GUARANTEE:	
150 SEGMENTS PER CRT X 4 CRTs X 42 MOS. X $2.10 =	52,920.00
D. PROMOTIONAL SUPPORT:	
$11,349 COMPOUNDED ANNUALLY AT 10% FROM DATE OF AGREEMENT EXECUTION =	$13,108.10
E. TOTAL LIQUIDATED DAMAGES FOR APOLLO CONTRACT:	**$98,288.26**

SYSTEM ONE DIRECT ACCESS LEASE AGREEMENT	
PARAGRAPH 14 - EVENTS OF DEFAULT; CANCELLATION	
1) TOTAL MONTHLY LEASE CHARGE X MONTHS REMAINING:	
$1,105 X 42 MONS. =	$46,410.00
2) REIMBURSEMENT FOR FREE MONTHS:	
6 FREE MONTHS (ON AVERAGE) X $1,105 =	6,630.00
3) EQUIPMENT REMOVAL CHARGE:	$750.00
TOTAL LIQUIDATED DAMAGES FOR SYSTEM ONE CONTRACT:	**$53,790.00**

Senator METZENBAUM. Thank you, Mr. Buckman.

We will now hear from you, Mr. Kotar.

Mr. KOTAR. Good morning, Mr. Chairman. My name is——

Senator METZENBAUM. Would you bring the mike closer to you also, please?

Mr. KOTAR. My name is Barry Kotar. I am the President of Covia Corporation, presently a wholly-owned subsidiary of United Air Lines, which owns and operates the Apollo Computerized Reservation System or CRS.

I am pleased to be invited here today to express the views of United Air Lines and Covia Corporation with respect to the subject of possible legislation or regulatory action directed toward the ownership and operation of CRSs.

As you may imagine, United and Covia as parties having an ownership interest in a CRS are strongly opposed to further regulation of the CRS industry, especially that which might restrict or dictate the way CRS owners or vendors may conduct their business.

United, one of the pioneers in the CRS market, elected a considerable business risk to invest over $250 million to develop and refine the Apollo System. I would like to note for the record that on the statement submitted, on page 23 there was a typographical error in the dollar amount. The correct amount is $250 million.

We made this investment at a time when it was by no means certain that Apollo would be a commercial success. Now that we are beginning to reap the rewards of our enterprise and innovation, certain firms that lack the business acumen and courage to make capital investments and otherwise commit scarce corporate resources, now wish to redress their past managerial inadequacies through government regulation.

The CRS industry for years now has been subject to intense government scrutiny and is now operating under broad-reaching regulation that substantially restricts vendors in the operation and marketing of their CRS's. Also, many of the challenged CRS practices and policies are now under review before various Federal and State courts.

There has been insufficient time to gauge whether the government imposed rules have had the effect on competition in the CRS marketplace that was contemplated by their designers. Furthermore, while certain pertinent court decisions have been received, others are still in prospect. Because the effect of governmental action, regulatory and judicial, are still not well defined, and for reasons presented in my statement, any further regulation by this subcommittee at this time is inappropriate.

Senator METZENBAUM. I did not get that last statement. I did not hear that last statement.

Mr. KOTAR. I said because of the effects of government regulation, both regulatory and judicial, are still not well defined, and for reasons presented in my statement, any further regulation by this subcommittee at this time we believe would be inappropriate.

Such regulation on the present record could unfairly deprive United of the opportunity to continue to derive the benefits which are the fruits of our expenditures and efforts. Such action is fundamentally inconsistent with the philosophy of free enterprise and free markets.

Just as important, the market under scrutiny is not one which requires protectionist regulation. Competition in the CRS market and the air transportation market is healthy and heeded. In the CRS market, for example, five major competitors are battling vigorously to increase their respective market shares and to add a growing number of travel agents to the list of their customers.

In particular, SystemOne, the CRS owned by Texas Air Corporation, is aggressively pursuing a strategy of inducing travel agents, which have contracted with another CRS, to breach their contracts and to sign on with SystemOne. Indeed, SystemOne has stated publicly that it intends to increase its market share to at least 30 percent of the market in a very short period of time.

As a result of this aggressive competition among the CRS vendors, the travel agents' position in the market has been protected as well. With the number of systems to choose from, each willing to provide sizable inducements, often in cash, many travel agents have been willing and even able to breach existing contracts to convert from one system without suffering any appreciable detriment.

SystemOne, for example, provides complete indemnification to agents which converts to its system, even to the extent of judgments and attorneys fees incurred in the breach of contract litigation that often follows a conversion. Consequently, the travel agents have been converting freely from one system to another, often bargaining for increased benefits and concessions.

The only way that vendors can protect against a breach of its contract with travel agents and thus protect its investment it is making with each location it installs is to insist upon contractual protection in its agreements with its agents. The contract provisions under discussion are no more burdensome than those found in any ordinary, everyday contracts among firms operating in other businesses in this country.

Where travel agents agree to the co-host provisions at issue here, such as minimum use and liquidated damages, they have done so voluntarily and with no coercion.

Senator METZENBAUM. Would you wind up, please?

Mr. KOTAR. As my written statement and a close examination of the markets in question will show, there is no need for regulation or legislation. Such action would serve an anti-competitive, rather than pro-competitive effect. While we do not believe that there are any problems for competition or for consumers to which such actions should be addressed, any such perceived problems will be best addressed by the workings of an unrestrained market.

Permitting the market to function, at least until clear and convincing evidence for the need for corrective action is presented, is the only feasible choice.

Thank you.

[The prepared statement of Mr. Kotar follows:]

STATEMENT OF UNITED AIR LINES/COVIA CORPORATION BEFORE UNITED STATES SENATE JUDICIARY COMMITTEE

United Air Lines, Inc. ("United"), on behalf of itself and its subsidiary, Covia Corporation ("Covia"), through Barry Kotar, President of Covia, submits the following statement in response to the request of the United States Senate Judiciary Committee. This statement is intended to be responsive to specific questions posed by this Committee with respect to various practices and procedures engaged in and utilized by vendors of computerized reservations systems ("CRSs") and the effects of some or all of these practices and procedures on competition in the markets for CRS services and air transportation. In addition, this statement describes the CRS marketplace from United's perspective and explains why additional governmental regulation of the marketing and use of CRSs is wholly inappropriate.

INTRODUCTION

In order to consider the necessity and propriety of further regulation of the CRS market, this Committee must first understand that market as it now exists. It is essential that a brief description of these conditions be given as a backdrop against which to address the specific questions which have been raised. As these comments show, the current market is intensely competitive and has no need for artificial constraints to protect CRS vendors which compete in the market, travel agents who utilize the CRSs, or consumers for whom the travel agents are acting in accessing the systems.

When the Civil Aeronautics Board adopted its CRS rules in 1984, the CRS market was still in its formative and developmental stages. Because the CAB found that certain actions were being taken by CRS vendors, which were also airlines, for the presumed purposes of enhancing their competitive positions in the market for air transportation or of creating competitive disadvantages for certain of their airline competitors, the CAB determined, that regulation was necessary to protect competition and to prohibit the unfair or discriminatory use of the CRSs by their vendors. In essence, the CAB rules, by which CRS vendors have been abiding since their adoption in November, 1984, preclude CRS vendors from charging differing booking fees to different airline participants, utilizing biased displays on the display screens of the CRS to give a preference to the schedules or flight information of some carriers over others, and entering into subscriber contracts with travel agents with terms in excess of five years.

The rules formulated and adopted by the CAB are premised on a set of assumptions about the CRS market: (1) that a CRS can be used to enhance the competitive position of an airline which either owns or participates in it; (2) that the owners of CRSs, by virtue of that ownership, possessed market power which could be used to increase market share in the air transportation market; (3) that the market power of the CRS in the marketplace gave them the ability to require travel agents to agree to contracts containing overly long duration terms or burdensome provisions; and (4) that there were barriers to entry into the

CRS market. It is these assumptions, or variations of them, which lead to the suggestion that still more regulation may be required. Passing the question of the viability of these assumptions in the pre-CRS Rule era, they certainly are not justified in the current market.

In the first place, as the comments below demonstrate, it is clear (we contend) that the ownership of a CRS does not result in an enhanced competitive position for the owner of the system. Second, although exclusion from a particular CRS (permitted by the CRS vendor, see 14 C.F.R. 255.9(a)) might arguably cause competitive harm to the excluded airline, a fact in itself subject to challenge because of the increased number of viable competing systems in the market, it is highly questionable that a biased position, or preferential screen display, will have any significant competitive effect. Third, the increased competition among owners of CRS's has enhanced the negotiating strength of travel agents. And finally, the increased strength of competing CRS vendors other than United and American, and the willingness of such vendors to commit capital resources to the improvement and marketing of their systems, have minimized, if not eliminated many of the alleged barriers to entry that might arguably have existed at an earlier day.

As a factual matter, changes in the marketplace since 1984 have resulted significantly from changed perceptions about CRSs and their capabilities. When they were originated and first used, they were perceived primarily as a marketing tool which could enhance the marketing and distribution of the airlines' principal product, air passenger transportation.

At about the time of the CAB CRS rules, however, a different perception was emerging. CRS vendors noticed, in part as a result of the CAB rules themselves and their requirement that non-discriminatory fees be charged, as well as their elimination of biased display as a benefit of the system, that booking fees were becoming a substantial source of revenue, quite apart from any effect that participation in the system might have on the air transportation share. With the passage of time, the CRS being marketed by a particular vendor began to be viewed as a stand-alone enterprise.

Indeed, it was an enterprise with significant economic potential. Not only could a CRS vendor collect booking fees from participating air carriers whose tickets were booked through the CRS, but the vendor could avoid paying booking fees to other vendors where it was its system, and not theirs, through which its own bookings were made. Vendors began to realize the value of a CRS on its own merits, rather than merely as a marketing tool to serve the airline's distribution needs. More and more, it became apparent to airlines which might not at the outset have devoted the resources necessary to develop or improve their CRS capabilities that there was value in having a CRS and in taking steps to increase the number of agencies in which their CRSs were placed.

One such aggressive carrier has been Continental Airlines, the owner of the SYSTEMONE CRS. SystemOne has not only proselytized agencies throughout the country to sign onto its CRS; it has even promised to indemnify those agencies which will agree to breach their existing contracts with another CRS vendor and convert to SystemOne. This indemnification extends even to defending breach of contract lawsuits which might be brought by the vendor from which the agency converted and paying any damages for which the agency might be found liable. Using this strategy, SystemOne has announced publically that it intends to capture in excess of thirty per cent of the CRS market in a very short period of time.

Of course, this change in perception, and thus the change in marketing strategy by such competitors as SystemOne, has resulted in a drastic change of circumstances for the travel agents whom the CRS vendors are seeking as subscribers. Such agents can no longer claim to be at a significant disadvantage in dealing with vendors. The ability of agents to convert from one system to another, even to the extent of disregarding valid contractual commitments, has given them increased leverage in their ability to deal and negotiate with CRS vendors. They, of all the players in the travel market, do not need the protection of federal regulation.

Against this backdrop, United will address the specific concerns raised by this Committee's questions:

1. BOOKING PRACTICES

When United first developed its APOLLO system and began to market it, there was a presumption (in some quarters) that the mere use of Apollo by travel agents, coupled with a biased display, would result in increased bookings and revenue for United through those agents. Indeed, this supposition was perpetuated for some period by findings that United's share of bookings generated in agencies using Apollo was greater than in agencies using a competing system, such as American's SABRE system. Because the evidence tended to support the expectation, no one bothered to challenge the presumption.

As time went on, however, United personnel did begin to question the hypothesis. While it was true that the United share in Apollo agencies remained higher than in non-Apollo agencies, it was also true that agencies inclined to subscribe to Apollo were agencies which either already had an allegiance to United by virtue of dedicated sales efforts continually made by United sales personnel (including sales incentives) or were located in areas where United had a healthy presence in terms of air transportation market share. In either such circumstance, it is logical that the United share in the agency should be greater simply by virtue of those circumstances. Moreover, where Apollo is installed, the United sales personnel, who market both Apollo and United, have an increased ability to visit and establish a rapport with the agents. Finally, although United cannot (under the CRS Rule) and does not grant incentive and override programs simply because an agent selects Apollo, it is often the Apollo agent, because of these other circumstances, who is in the best position to request and qualify for such programs.

At present, United no longer operates on the assumption that the mere presence of Apollo in an agency is the cause for increased United air transportation share in that agency. Although it is a complicated mix of factors that contributes to the phenomenon, there is simply no support for the original assumption. Indeed, there is contrary evidence: In an area where the marketing and installation of Apollo were not done by United sales personnel, but by the sales personnel of another airline under a joint marketing agreement, the share of United bookings in the Apollo agencies was less than United's share in Sabre agencies and unautomated agencies in the same geographic area.

United's present sales program is premised on the assumption that the Apollo share is likely to increase in areas where United has more substantial air transportation, and not that its air transportation share is likely to increase where the Apollo share is substantial. This conclusion is based in part on comments and opinions expressed by travel agents to United personnel, and also on the fact that many of the conversions from Apollo to other systems by travel agents has occurred in areas where United either does not have substantial service or where it has recently reduced service.

This lack of causal relationship between CRS share and air transportation share, at least with CRS as the causative factor, would appear to diminish the significance of the Committee's questions with respect to the consumers' knowledge of the ownership of the various CRSs. However, it is believed that most frequent travelers probably know that the CRSs are owned by airlines. Consumers probably do not know, of course, which system their travel agents are using to make their reservations. The disclosure of such a fact should not make any real difference, especially since there is no longer any biased display or other mechanism inhering in the CRS itself that would incline an agent to make a particular booking on the airline which owns the CRS. Indeed, if a travel agent is doing its job, it will premise its recommendation for a particular carrier or a particular flight on the preferences expressed by the customer as to flight time and other factors. If the aim of this Committee is to allow the consumer to understand a travel agent's economic motivation behind his recommendation of a carrier, it makes far more sense to require a travel agent to disclose any incentive or commission arrangements it might have with a carrier than to disclose the CRS it is utilizing.

As to the question of display bias, bias has been totally eliminated in the Apollo system pursuant to the CAB rules. For some period of time following the adoption of the CAB rules, United, and perhaps other vendors, utilized some minimal bias on a secondary display screen. This bias, which was permitted under the rules, thus affected only display screens which were called up on the system at the request of the travel agent using the system. Because of its format and function, it did not have the effect of inhibiting competition or even giving any airlines a competitive advantage. In any event, all such bias has now been totally eliminated from Apollo.

As previously stated in these comments, the competitive effect of bias even on the primary display screen cannot be assumed. There are serious questions as to whether bias (which existed on CRSs prior to the CAB CRS rule) resulted in any real increase in bookings or revenues for preferred airlines. Moreover, any such presumed effect could have been diminished in a market in which travel agents diligently and carefully satisfied their duties owed to their customers. Bias can result in increased bookings for a preferred carrier only where the travel agent is unschooled in operating the system, where the agent has an overriding disposition to book flights on the preferred airline, or where the agent declines to seek out the additional displays and flight information available to all agents through the system.

2. BOOKING FEES

There is no evidence to support the notion that booking fees charged by vendors such as United to participating carriers, either under the schedule of fees utilized prior to the CAB rule or under the uniform fees charged to all participants since the rules were adopted, harm airline competition in any way. Indeed, participation in the various systems clearly enhances, rather than deters, competition by providing additional distribution channels for all airlines, and the fees charged for participation merely enable a vendor to recover its costs of developing, maintaining, and operating its system plus a reasonable return on investment and innovation. CRS vendors, including United, have previously justified the fees charged in materials submitted to the Department of Transportation and to the Department of Justice. The DOT after considering all the material before it elected not to adopt rate regulation. Instead, it barred discriminatory pricing and left to the marketplace the level of booking fees.

That the booking fees are not anticompetitive is also supported by the fact that all the participating airlines have continued to participate in the various systems and to pay the fees charged. At the very least, this indicates that the benefits derived from participation exceed the costs of participating and that the level of the fees does not result in losses to the airlines. If the fees were excessive, one could expect to see some airlines withdraw from various systems or restrict their participation to one or few systems. This, however, has not been the case.

Moreover, there has been no indication of any other kind of injury to participating airlines arising from the amount of fees charged. The fee is very small as compared with the fare charged by airlines to their passengers, and it cannot therefore be reasonably said that the fees thus result in any increase in the prices charged to consumers. Furthermore, the cost of making a booking is a cost that every airline must incur, and there is evidence that the CRS booking fees are a significantly lesser expense than the actual cost to the airline of making the booking and responding itself to the call from the consumer. Since the participation in the system at current booking fees thus results in savings to the participating carriers, it is difficult to see how competition is being disserved.

Certainly, the owners of the various systems derive no competitive benefit in the air transportation market. Although a CRS vendor does not pay booking fees for bookings made on it through its own CRS, it nevertheless absorbs the costs of making those bookings (through the costs associated with the development and operation of its CRS) just as it absorbs the costs of bookings made through its own reservations personnel. Moreover, in the case of United, United has established an independent subsidiary which owns and operates Apollo, and that subsidiary, Covia Corporation, charges United the same booking fee that is charged to all participants. In addition, United has announced that it will sell approximately half of its interest in Covia, thereby reaffirming Covia's independence. Any possible claim of competitive advantage to be derived by United from its ownership of Covia is thus totally eliminated.

Obviously, based on these comments, United is strongly opposed to any regulation or legislation directed toward the booking fees charged by CRS vendors, primarily because no need for such drastic action exists. The free competitive market is the best solution to any of the "problems" that this Committee, or parties who have petitioned this Committee, apparently perceive. To regulate or legislate the level or amount of booking fees that a vendor may charge would be to discourage ambitious and forward-thinking entrepreneurs from committing resources to new products and innovations and to deprive those same parties of the rightful fruits of their foresight and efforts. It would also serve only to protect particular competitors, and not competition, which needs no such protection. Any CRS vendor may reduce the booking fee it is charging and thus attempt to give air carriers the opportunity to assert leverage over competing vendors. Moreover, if there is any substance to a charge that such fees are unfair or the result of monopoly power, there are established remedies available to injured parties both under the antitrust laws and other governmental regulations dealing with the airline industry.

3. BARRIERS TO ENTRY

Notwithstanding the language of the Committee's questions concerning this subject area, the contract provisions such as liquidated damages and rollover and minimum use requirements cannot be equated to "actions which directly or indirectly prevent travel agents form obtaining and using another system". That statement, at the very least, tends to taint those contractual provisions with a presupposition of wrongfulness and evil intent that is insupportable. While several vendors, including United, have adopted and utilized the types of provisions described, the purpose and effect of those provisions is quite different from that implied in the Committee's questions.

United's current form subscriber contracts, which it has used since 1985, contain a liquidated damages clause, a minimum use provision, and a "rollover" provision requiring that the contract be extended for an additional five-year term each time a new location is installed with Apollo. Although the first two clauses are still treated as valid and enforceable, United recently announced to all its subscribers that the rollover provision will not be so treated. That clause will not appear in future Apollo contracts and will not be enforced prospectively in existing contracts.

The other two contract provisions, however, are valid and legitimate, and they should not be the target of legislative or regulatory efforts. The cited provisions do not provide any disincentive to an agent's obtaining or using another system in addition to Apollo, and they do no more to discourage an agent from removing Apollo and converting to another system than the subscriber contract itself. If these provisions were to be prohibited, the effect would be essentially to invalidate and emasculate subscriber contracts altogether.

In the present market, a CRS vendor may presumably enter into a subscriber contract of a specified term, not exceeding five years, with a travel agent who wishes to use the vendor's CRS. Under such a contract, the vendor must furnish the agent with certain services and access to the system, in return for which the agent agrees to pay certain fees and to perform certain duties. Typically, the vendor cannot refuse to continue to provide the required services without good cause. Presumably, the agent under the law is similarly bound not to breach the agreement.

Because United has invested substantial amounts of capital in the development of the Apollo system, because United incurs various costs and grants certain benefits to the agent in installing the system and negotiating the contract, and because the installation of each system in an agency represents a potential source of significant revenues in the form of booking fees, United prefers to include in its contracts provisions requiring that the agent make certain minimal use of Apollo and that the agent will be subject to certain specified damages in the event of breach. The minimum use provision is not burdensome. It simply requires a contracting agent to make a specified number of bookings, amounting to one half of the agent's monthly average of bookings over the first six months of the contract term, each month for the course of the contract. This provision thus allows an agent to grow and expand without increasing its monthly requirement throughout the contract, and it gives the agent ample latitude to make a large percentage of its bookings--usually more than half--on another CRS.

Similarly, the United liquidated damages provision is eminently reasonable. It merely defines--and limits--the damages that United may recover from an agent which breaches the subscriber agreement. It calls for the agent to be liable for 80% of the monthly fees and variable charges remaining over the remaining term of the contract, as well as an amount equal to the booking fees that would be generated by the agent's use of the system if the agent complied with the minimum use requirement for the remaining term of the contract. In other words, the provision approximates the actual damages and losses that United would incur as a direct result of the agent's breach. The liquidated damages clause is not intended as a penalty, but only as a shorthand measure of a reduced portion of those actual damages.

United does not know in every instance how other vendors may fashion their liquidated damages provisions. It does know, however, that its own clause is fair and equitable. If this clause were abrogated, the actual damages that United would be entitled to recover would exceed the amount called for in the clause.

On the other hand, the damages thus called for are appropriate. They are intended to compensate United for the losses under the breach, not to discourage agents from using other systems than Apollo. If vendors such as United are not permitted to recover such damages, then their contracts have no value whatsoever. In such a case, where vendors would have no protection against breach, the vendors would need to fashion other means, such as increasing the fees to be charged to travel agent subscribers, to ensure that they could generate satisfactory revenue under a contract to justify the costs and resources inherent in the installation and development of the system. Any such means is likely to increase the costs to the agent, and that does not appear to be a desirable result to incur, certainly not in the eyes of the travel agency community.

Moreover, the liquidated damages provision used by United has not impaired competition or the apparent willingness of some travel agents to breach their contracts and to convert to other systems. There are presently an ample number of competing systems, and the vendor of each is willing and eager to offer Apollo-installed agents substantial monetary inducements and pricing breaks to convert from Apolloto its system. One such vendor, SystemOne, which is owned by Texas Air Corporation, offers to indemnify any agent which will convert to SystemOne for all costs, damages, and losses, including judgments and attorneys fees incurred in litigation arising from the contract breach, which the agent may incur as a result of the conversion. This strategy, which has been successful, means that the converting--and breaching--travel agent suffers no detriment from its breach of contract and has no incentive to refrain from breaching its contract with Apollo.

That SystemOne or other vendors have incurred substantial costs as a result of this or similar indemnification strategies does not mean that competition has in any way been impaired. To the contrary, the competition is thus extremely heated. SystemOne, for example, has apparently determined that the benefits of adding new agents to its system far exceed the amounts that it is required to pay to the agents to induce them to breach their contracts with its competitors. Moreover, SystemOne has recently announced publicly that it fully intends to capture approximately one-third of the CRS market in the very near future. Plainly, this is not a market that suffers from lack of competition.

Notwithstanding this aggressive posture assumed by SystemOne, it is SystemOne itself that has spearheaded recent efforts, including those directed to the United States Congress, to obtain legislation or regulation limiting or eliminating the liquidated damages and minimum use provisions of subscriber agreements. This is not, however, out of any sense of altruism, or even a desire to enhance competition in a market which needs no such assistance. Rather, SystemOne's efforts have as their motive the protection of competitors, not competition. As observed by Professor Baumol, there is a

> "well known distinction between the protection of competition and the protection of competitors. The courts have held, quite appropriately, that the former is a proper objective of public policy, while the latter is clearly not. As a matter of fact, despite the similarity in their appearance, these two goals are essentially antithetical. A vigorous competitive process is inherently of no comfort to the individual competing firms which would, of course, find it easier to make profits if the market were less competitive.
>
> The point is that many legitimate acts by a business enterprise may make things harder for its competitors. For example, an innovation which increases a company's efficiency will obviously be disadvantageous to its rivals, and may conceivable even drive some of them out of business.

> Yet no one can, with any good reason, question the legitimacy of such improvements in efficiency, no matter how disadvantageous they are to the firm's competitors." 1/

Although SystemOne, of all people, has no real need for government protection, it sees a tremendous opportunity to increase its market share, to the detriment of its competitors, if it can persuade any governmental agency to hamstring its competitors by taking away their right to enforce what until now have been recognized as valid and enforceable contracts.

Viewed in this light, the essence of SystemOne's scheme is obvious. SystemOne is interested in penetrating the CRS market without the necessity of expending the capital and resources that some of its forerunners in the industry, such as United, American, and TWA, were required to expend at a time when the market was undeveloped and uncharted. The beneficiary of the proposals for legislation and regulation that have recently found their way to the federal government in various shapes and sizes is not the travel agent, who has suffered no injury from the accused practices, but SystemOne and other vendors which have elected to buy their way into the market.

4. INCENTIVE PROGRAMS

In answer to this Committee's first question under this heading, United believes that most consumers recognize that

---

1/ See, Comments of United Air Lines in the matter of CRS proposed Rulemaking, Doc. No. 41686, p. 10.

travel agents receive incentives for booking flights on the airline providing the incentive although many may not appreciate their nature and extent. United does not believe that any ill effects follow from this fact, much less any harm to competition or consumers. It would only be when a travel agent's interest in obtaining commission overrides or other incentives overrrode its performance of the duty owed to its customers that such harm might occur, and United has no reason to believe that the vast majority of travel agents are willing to forsake that duty.

Moreover, there is no evidence to suggest that the average traveler in the current market is lacking in sophistication and intelligence. They have definite requirements, such as scheduling or price, and are willing to ask intelligent questions about the travel arrangements being made on their behalf. Where the consumers are less sophisticated, they will nevertheless be guided by those same types of criteria and will, almost without exception, ask for alternative flights and prices on other airlines. It is highly unusual that a travel agent can convince a customer to fly on a particular carrier or flight purely upon its own recommendation.

Finally, the offering of commission overrides and other incentives increases, rather than decreasing, competition among the airlines. It is a device which is available to all carriers, much as similar devices are available to competitors in other distribution-oriented industries. To eliminate the ability to utilize incentives to travel agents would be anticompetitive, not pro-competitive, as the first step in the regulation of what is now a freely competitive market.

5. ACCESS TO MARKETING DATA

The airlines which own CRSs are not deriving an unfair competitive advantage from access to marketing, booking, and sales data generated by their systems. In fact, there is no significant data which remains purely in the possession of the CRS vendors in the wake of the CAB rules. All information, as required by the rules, is made available to all carriers, upon request, at a reasonable charge calculated to compensate the vendors for processing and calculating the data. There is, moreover, no indication that any vendor has obtained an unfair advantage through the use of marketing data.

This point is well accentuated by the fact that United established Covia as an independent subsidiary and is in the process of selling approximately one half of its interest in Covia. If the access to the marketing data was a significant competitive benefit, it is unlikely that United would part with it. Dealing with Covia on an arm's length basis, United will be required to pay Covia for the marketing data it receives, and it will receive no more than any of its competitors that request the data.

6. CRS AND AIRLINE MARKET CONCENTRATION

There is no indication that competitive forces in the CRS market have contributed in any way whatsoever to increasing concentration in the airline industry. In fact the contrary proposition is true: we contend that there can be no doubt that CRSs have contributed (and offer the continuing potential of contributing) to new air carrier entry because CRS provides a ready vehicle for an untried and unknown product to be introduced and provided to consumers throughout the country and world at no cost to the fledging carrier unless and until a booking is made. Because (as demonstrated in these comments) there is no apparent competitive benefit running to airlines that own CRSs, there is obviously nothing to suggest that the lack of success or poor financial conditions of some airlines, which have subsequently been the subjects of takeovers or mergers, is attributable in any way to the presence or absence of any CRS. Moreover, since all airlines have the opportunity to participate in any CRS on the same terms as their competitors, it is more likely that the existence of CRSs was a positive, rather than a negative, factor in the operations of those airlines in increasing their distribution channels and their booking capabilities.

A number of the recent mergers in the airline industry have clearly had no relationship to CRSs. In the USAir/Piedmont merger, for example, neither airline owned a CRS. Even where one of the two merging parties has been the owner of such a system, as in the TWA/Ozark merger, there has been no evidence that the ownership of the CRS was a significant factor in the decision to merge. Moreover, even if ownership of a system were a determinative factor, other airlines have merely entered into joint ownership or marketing partnerships to permit them some additional control over such systems.

Finally, increased concentration in the airline industry was a result that was contemplated and predicted as a natural and perhaps necessary consequence of deregulation. Most economists foresaw that small and inefficient competitors would have substantial difficulties in trying to compete in an unregulated industry. Indeed, under the American economic system, one of the inevitable consequences of competition in a marketplace unfettered by the "dead hand" of government regulation is the elimination of some inefficient competitors and the establishment and growth of efficient competitors, thus providing consumers with better, more efficient, and less costly services and products. Where competitors have adopted better and more economical means of marketing their products and selecting profitable routes, they have survived. None of this, however, has anything to do with CRSs.

7. DIVESTITURE

Divestiture is the worst potential solution to problems that may not even exist. Obviously, United opposes any effort to interject divestiture in the CRS market, especially where the problems suggested by this Committee have not even been shown to be real or meaningful. We have addressed the concerns stated by the Committee in the comments above, and we have repeatedly stated our position that the use and ownership of CRSs by airlines do not result in any anticompetitive affects in the markets for CRSs or air transportation. These comments are submitted in good faith and show, at the very least, that the issues are not so clear-cut as proponents of legislative or regulatory efforts might suggest.

In the absence of clear and convincing evidence that such problems do exist, and that no solution short of divestiture will suffice to solve them, divestiture should not be required. Divestiture is a drastic remedy which should be adopted only as a very last resort. It is a remedy which, if adopted, will cause great harm to owners of CRSs and may violate various provisions of the United States Constitution.

As the owners of CRSs have continually advised the various agencies and Congressional authorities to whom they have submitted comments or testimony from time to time, the development of each CRS required huge investments of time, money, and resources. United, for example, spent in excess of $250 million in the development of Apollo. Divestiture would do no less than to deprive United and the other CRS owners of the fruits of that investment without any real possibility of fully realizing the return to which their efforts and foresight entitle them. To require divestiture would thus defeat the kinds of incentives for innovation, invention, and entreprenurial spirit that the free market traditionally encourages and embraces.

Moreover, divestiture would probably constitute a violation of several of the constitutional guarantees of which United and the other CRS owners are entitled to avail themselves. It is highly unlikely that the extreme remedy, in the factual context of the CRS market, could ever satisfy the "just and fairness" standard or otherwise defeat a challenge to its legality. Moreover, divestiture in this situation might also be vulnerable to attack as a violation of the CRS owners' rights to substantive due process, to the protection of the First Amendment, and to equal protection under the law.

Finally, the practicalities of the CRS militate against divestiture. In each existing CRS, including Apollo, the software which runs Apollo is totally intertwined with the internal computer reservations system of United. There is no way that the Apollo software can be fully segregated from the United system. While United and Covia have struck an agreement as to the respective rights of both parties and have guaranteed that United cannot utilize the Apollo system and data improperly for its own benefit, compliance with an order of divestiture would require at great economic cost (including loss of certain economies of scale) that either United or Covia substantially replicate the present Apollo system in order to serve its own business needs.

CONCLUSION

For the reasons stated herein, United contends that no government regulation of the CRS industry is warranted at this time.

Respectfully submitted,

Barry A. Kotar
President and CEO
Covia Corporation

Stephen P. Sawyer
Assistant General Counsel

J. Craig Busey
Senior Counsel

United Air Lines, Inc.

Dated: December 10, 1987
Chicago, IL

Senator METZENBAUM. Thank you very much, Mr. Kotar.

Mr. Richard Murray, President and CEO, SystemOne, Inc.

Mr. MURRAY. Thank you, Mr. Chairman.

Before I make my oral remarks, I would like to comment, if I may, on the video-display unit located to my left. We have requested and received the concurrence of your staff to install a travel agency terminal for the purposes of answering questions or making demonstrations during the course of the hearing and we would be glad to present a demonstration following the hearing to you or to members of your staff.

Senator METZENBAUM. Thank you very much, Mr. Murray.

Mr. MURRAY. Mr. Chairman, I appreciate the opportunity to appear before you today and to participate in the subcommittee investigation of Computer Reservation Systems. For many years, I have been intimately involved in the development and utilization of Computer Reservation Systems. As a former executive of American, and now as President of SystemOne, I have seen first-hand both the tremendous benefit and regrettably the actual harm that these systems present to the airline industry and the traveling public.

The issues being discussed during this hearing are of great concern to thousands of travel agents across the country who depend on their livelihood from their airline and CRS relationships. In fact, the problems dealing with this subject have even reached global proportions, as we see foreign airlines forming CRS consortiums in an effort to protect themselves in this environment.

The CRS marketplace today is in serious trouble. The rules established by the CAB in 1984 for the purpose of ending the abuse of market power by the major vendors, American and United, clearly have not worked. Time after time, these vendors have tested the boundaries in a blatant disregard for both the spirit and the letter of the CAB's rules. They have used their control over a huge share of the CRS market to manipulate consumer choice in favor of their own flights at the expense of the consumer and competing airlines.

In its 1985 report, the Justice Department stressed that "developments may establish that buyouts and the sign-up of new agents is sufficient to allow new entry and expansion or at least to provide a sufficient threat of new entry or expansion to deter an exercise of market power by incumbent CRS's." That simply has not happened.

The heavy-handed tactics of American and United have made it almost impossible for their travel agency subscribers to freely choose another CRS. On their face, the American and United subscriber agreements comply with the CAB rules which stipulate 5-year maximum terms, but these two vendors have consciously sidestepped the rules by requiring automatic extensions of the contract terms each time the travel agency subscriber wants to install a new piece of equipment. Since this happens on a regular basis as travel agencies grow, the subscriber agreements are in effect never-ending and the agent never has a chance to make a new choice, even when switching systems is beneficial to their business.

They also include punitive, liquidated damage clauses in their subscriber agreements. A travel agent who wishes to terminate an American or United contract before its expiration is required to pay all of the lease payments that would have come due over the remaining life of the contract, which is not unreasonable.

But what is unfair is that the agent must also pay a substantial portion of estimated booking fees that American or United would have collected from other airlines over the same period. It is noteworthy that these provisions were introduced as a means of inhibiting competition after the CAB rules were adopted.

These penalties could mean hundreds of thousands of dollars for small travel agents. Both airlines have enforced these restrictive clauses by suing travel agents who have had the courage to switch. This year alone, American and United have filed over 20 such lawsuits, and they have made clear with their threats that they will continue to drag travel agencies through the courts in the future.

As if being involved in a lawsuit were not enough, various other intimidation tactics have been used by American and United to keep their travel agency subscribers in line. I have talked with the managers of a number of travel agencies who say they would like to use SystemOne, but are afraid that American and United will strip them of override commission payments——

Senator METZENBAUM. Please wind up, Mr. Murray.

Mr. MURRAY. Yes—deprive them of other advantages they have enjoyed in the past and/or generally make life very difficult for them.

I strongly believe that unrestrained and fair competition in the CRS industry can yield enormous benefits to the airline industry and consumers of airline services, but in the current marketplace competition is not unrestrained or fair.

I believe that it is extremely important that there be legislation adopted that will prohibit CR Systems from entering into or enforcing punitive damage provisions in agency subscriber agreements. I believe that action is needed to eliminate continuing gaps between the treatment of host airlines and the treatment of other airlines.

Thank you.

[The prepared statement of Mr. Murray follows:]

STATEMENT OF RICHARD E. MURRAY, PRESIDENT AND CHIEF EXECUTIVE OFFICER, SYSTEMONE DIRECT ACCESS, INC.

Chairman Metzenbaum and Members of the Subcommittee, my name is Dick Murray. I am the President and Chief Executive Officer of SystemOne Corporation, the technology and information management subsidiary of the Texas Air Corporation. I have spent over three decades in the air transportation industry, working with such airlines as Texas International, Ozark, Allegheny/Mohawk and American. For the past several years, I have been directly involved, first with American and now with SystemOne, in the development and utilization of computer reservation systems.

I very much appreciate the opportunity to appear before you today, and to participate in the Subcommittee's investigation of Computer Reservation Systems ("CRSs"). In my judgment, these hearings could not be more timely, or more necessary. The abuses that have occurred in the marketing and operation of CRSs by the two major vendors have had a direct and substantial adverse impact not only on the travel agency and air transportation industries, but most importantly on the welfare of American consumers. Despite numerous government investigations and a landmark 1984 rulemaking by the Civil Aeronautics Board ("CAB") designed to stop these abuses, conditions in the marketplace have, if anything, grown worse.

American Airlines and United Airlines, the two largest CRS vendors, have deliberately ignored and violated the spirit, and in many cases the letter, of the CAB's 1984 Rule. By employing a combination of intimidation tactics, *de facto* exclusive contracts with travel agencies, and retaliatory litigation, American and United have made it *more* difficult, not less, for travel agencies to use CRSs offered by competing vendors. Moreover, American and United have continued to use their control over a huge share of the CRS market to gain an unfair competitive advantage over rival airlines. Thousands of small travel agencies and millions of consumers have been injured by this array of anticompetitive practices. Unfortunately, the prospects for improvement in the

CRS industry without further government action are remote. SystemOne welcomes the Subcommittee's investigation, and the prospect of decisive remedial legislation.

I.

OVERVIEW OF THE CRS INDUSTRY

As the members of the Subcommittee are aware, SystemOne is one of the only five CRS vendors in the United States. SystemOne began marketing its CRS to travel agencies in 1981 and is now a subsidiary of Texas Air Corporation, which in turn is the parent of both Continental Airlines and Eastern Air Lines. The other four domestic CRS vendors are also affiliated with or owned by major domestic air carriers. American Airlines owns the SABRE CRS; United Air Lines owns the APOLLO CRS, the PARS CRS is jointly owned by TWA and Northwest, and Delta owns the DATAS II system.

Of the five domestic CRS vendors, American and United are the oldest and far and away the largest. Nationally, over 65% of travel agencies which use CRSs are under contract to use either American's SABRE system or United's APOLLO system. In important local and regional markets, the dominance of these two vendors is even more pronounced. I have attached as Exhibits "A" and "B" to my prepared remarks two tables which show our most recent estimates of CRS market shares in selected states and cities.* To take but a few examples, United and American share 71% of all CRS locations in Alabama; 70% in Arizona; 78% in California; 98% in Hawaii; 83% in Illinois; 75% in Massachusetts; 88% in Michigan; 90% in New Hampshire; 69% in New York; 72% in Ohio; 49% in Pennsylvania; 37% in South Carolina; 81% in Texas; and 84% in Utah.

---

* Exhibits "A" and "B" do not provide market share information for Delta's DATAS CRS because Delta does not distribute the type of information used in compiling the exhibits. It is estimated that Delta has approximately 5% of CRS locations nationwide. The market shares shown on Exhibits "A" and "B" are measured as percentages of CRS locations, i.e., discrete travel agency locations. The number of locations in a given area does not necessarily equal the number of travel agencies in that area, since some travel agencies have more than one location. Significantly, the market shares of American and United shown on Exhibits "A" and "B" would be considerably higher if measured in terms of revenues generated by CRS bookings rather than locations. On average, SABRE and APOLLO locations generate at least 30% more annual revenues than SystemOne locations or PARS locations.

Consumer access to accurate and complete market information is vital to effective competition in any industry. Without reliable information about the costs and benefits of alternatives in the marketplace, losses in consumer welfare are to be expected. Conversely, a free flow of information to the consuming public drives the engine of competition and is an essential means of translating competition into consumer benefits: Inferior competitors cannot hide their shortcomings, and superior competitors have a means of ensuring success in the marketplace on the merits.

In the market for airline services, CRSs have become the essential medium of consumer information. All but the smallest travel agencies now use CRSs to make reservations for their customers. More than 75% of all airline bookings are made by travel agents, and more than 90% of travel agency bookings are made by using a CRS. The rapid growth in CRS usage is easily explained: computerized systems offer unmatched technological advantages that have become essential in a post-deregulation environment marked by a proliferation of fares, airlines, and flights.

A CRS consists of one or more central locations at which the system's processing and storage units are housed and a large number of computer terminals located in travel agency offices and elsewhere which are linked by telephone lines to the system's processing and storage units. The system stores, analyzes, and displays on the terminal screens a vast quantity of detailed and rapidly changing information about airline schedules, fares, and seat availability for thousands of city-pairs and millions of different flight segments. CRSs enable travel agents to identify available flights and ticket prices, to make reservations, and to issue tickets in a fraction of the time that would be needed to perform those tasks manually. CRS enhancements also permit travel agencies to reserve seats and issue boarding passes, and to provide ancillary services such as rental car and hotel reservations. The end result is that CRSs have become indispensable to virtually all travel agencies.

At the same time, the widespread availability of CRS technology has made possible dramatic improvements in the services provided by travel agencies to the consuming public. Through its use by travel agencies, a CRS can make available to airline passengers almost instantaneous access to accurate and current information about the most convenient flights and the lowest fares. As a source of vital consumer information about competitive offerings, a CRS has the potential for substantially enhancing consumer welfare in a competitive airline industry.

Unfortunately, much of that potential has not been realized. The very features of a CRS which make it a powerful and essential ingredient of effective competition also make it an equally powerful means of restraining competition if used to distort the flow of information to consumers. The power to manipulate consumer choice, which is inherent in unconstrained control over any essential source of consumer information, also provides a strong motivation for less scrupulous competitors to obtain and preserve such control, by fair means or foul.

The history of the CRS industry, brief though it is, has been marked by precisely this type of abuse: Two major air carriers have obtained and preserved power in the CRS market because it provides a means of controlling the flow of vital consumer information. And they have used that power to distort information about the service offerings of rival airlines, to the detriment of consumers and competitors. Moreover, because the database of the CRS necessarily includes detailed information about the marketing practices of competitors, major airlines have used their control over CRSs to monitor activities of the competition and to plan retaliatory responses.

II.

A BRIEF HISTORY OF THE CRS INDUSTRY

A. Origins of the Industry and Early Abuses

Beginning in the 1960s, airlines developed computerized reservations systems for their own internal use. Ultimately, the airlines became interested in making computerized booking and ticket-writing functions available to travel agencies as well, as a means of reducing the airlines' burden of performing those functions themselves. Initially, there were discussions in the industry about creating an industry-wide "neutral" booking system that would make information about the flights to all carriers available to travel agencies on equal terms. This idea foundered when the two largest carriers, American and United, opted to create and market their own proprietary CRSs (SABRE and APOLLO, respectively). Shortly thereafter, TWA began marketing its own proprietary CRS (PARS).

At first, American and United offered their systems to travel agencies at little or no cost, planning to recoup their investment from two other sources. First, they charged "booking fees" to other airlines in exchange for listing their flights on the SABRE and APOLLO system. The booking fees were per-segment payments which would be made by participating carriers each time one of their flights was booked through the CRS.

Second, American and United expected to earn "incremental revenues" from increased ticket sales on their flights. American and United did not leave this to chance. Instead, they intentionally distorted the information transmitted by their CRSs in order to ensure that increased use of their computerized systems would lead to increased sales of their tickets. This was accomplished by systematically "biasing" the display of information on the computer terminal screens to favor American and United flights, and in many cases to suppress the flights of rival carriers. In a 1981 analysis, American determined that over 53% of all SABRE sales came from the first line of the first screen displayed, and 92% of all sales came from the first screen. American and United simply made sure that their own flights appeared first on the display screens. In this way, they made their travel agency subscribers unwitting participants in a premeditated scheme to manipulate consumer choice. In the process, consumers were denied fair and accurate information that would have led to sales of cheaper or more convenient flights offered by competitors of American and United. Thus, the two carriers earned "incremental revenues" at the direct expense of consumer welfare.

In 1981, two other air carriers entered the CRS market. Eastern began marketing SystemOne, and Delta entered the market with DATAS II. SystemOne differed from SABRE and APOLLO in that it pioneered an enhancement called "direct access," which permitted its travel agency subscribers to look directly at the internal flight inventories and reservation database not only of Eastern, but of other air carrier participants in SystemOne.

This was an important technological advancement. It gave travel agency subscribers a greater level of confidence in quoting flight availability and fare information to passengers. The agents could quote flight and fare information from the system's "primary screen," and then confirm the flight availability and fare information by directly accessing the database of the carrier whose flight had been selected by the customer. Direct access also permits the travel agent to verify that the seat has in fact been reserved in the carrier's internal system once the instructions have been entered on the agency's terminal.

While SABRE and APOLLO also developed direct access features, they did so only after SystemOne entered the market, and neither displayed a level of commitment to market this advancement and train travel agent subscribers to maximize its benefits. For example, American has charged participating carriers substantial sign-up fees for the direct access enhancement, and it charges subscribers monthly fees to have access to this important tool. The result is that less than 10% of all SABRE subscriber sales are made through direct access. One might well ask why CRS vendors would not aggressively market such an important tool to travel agents and their customers. The answer is that the better the access provided by American and United to other carriers who participate on their CRSs, the more that the "host advantages" of American and United are reduced.

Built-in host advantages are informational advantages that accrue to only the host carrier because the airline and travel agent systems are one and the same. By contrast, information about offerings of participating carriers must be communicated to the host's CRS through a computer link between the CRS and the participant's internal database, and communication delays are a possibility. As a result, information about schedules, fares, and discount seat availability is more current and accurate for the host carrier's flights than for those of the other participating carriers. Travel agents have a greater degree of confidence when selling the host carrier because of the integrity of the information, and the fact that the travel agents do not have to risk a communication link between systems to consummate a host transaction.

SystemOne has marketed its CRS as a direct access system with the primary intent of providing the most complete information not only for the host, but for all airlines, to its subscribers and ultimately to consumers. At the time SystemOne initiated its service, it believed -- and it continues to believe -- that there would be significant demand for the direct access enhancement.

Nevertheless, at the time SystemOne began its marketing efforts, American and United already had a firm lock on the CRS market, and they had structured their agreements with travel agency subscribers in ways that made it extremely difficult for new competitors to break that hold. United's contracts required its subscribers to stay with APOLLO for from seven to ten years. United also adopted exclusivity clauses which had the effect of preventing APOLLO subscribers from using a second system. American achieved similar results by the use of long contract terms and by inserting minimum-use clauses in its agreements, which required subscribers to make a minimum percentage of bookings per location on the SABRE system. (The percentages were sufficiently high that adding a second system was totally cost ineffective for most subscribers.) In addition, both United and American adopted liquidated damage clauses which required agency subscribers who might convert to a competitor to pay all or a substantial portion of equipment rental payments that would have been due over the life of the contract.

All of these contractual devices, and other associated tactics, were implemented for the purpose of making it as difficult as possible for APOLLO and SABRE subscribers to use competing CRSs. By maintaining their dominant market share, the two carriers also made it possible to continue earning "incremental revenues" from their control over the CRS information medium. The significance of these "incremental revenues "should not be underestimated. For example, according to American's own analysis, it earned $21,000 in incremental revenue per SABRE location in 1981, and earned total incremental revenue of $78.5 million from SABRE locations in 1980 (when it had only 30% of the CRS locations that it currently has). The incremental revenue stream was estimated by United in 1982 to be worth in excess of $165 million, and there is good reason to believe that American and United significantly understated the revenues. Since these "incremental revenues" were the main economic benefit derived from the CRSs, retaining them was the main reason for keeping agency subscribers hostage to the APOLLO and SABRE systems.

In addition, American and United continued to manipulate the flow of information through SABRE and APOLLO in order to punish rival carriers that had stepped up competition in particular markets. For example, from November 1981 to February 1982, American suppressed from its "Shoppers' Fare Quote" display Continental Airlines' "supersaver" fares in 63 individual city-pair markets. In other words, rather than matching those fares, American simply deleted them from SABRE's price-comparison display. Continental was not the only loser; tens of thousands of passengers lost the chance to buy cheaper tickets.

To take but another example, when New York Air entered the LaGuardia-Detroit market in competition with American, American manipulated SABRE to make sure that the New York Air flights would be buried far down in the display sequence. This substantially reduced the likelihood that travel agency subscribers would ever quote the flights to passengers. New York Air lost substantial numbers of bookings as a result of the SABRE display bias, and was shortly forced to pull out of that market. Again, LaGuardia-Detroit passengers were the real losers. (These and numerous other instances of display manipulation by American and United were documented by the Justice Department in its November 1983 Comments and Proposed Rules in CAB Docket 41686.)

B. The CAB Rulemaking

At the urging of Congress and the Department of Justice, the Civil Aeronautics Board ("CAB") initiated a rulemaking proceeding in 1984 to redress the abuses that had occurred in the CRS industry. Based on an extensive investigation, which focused on the practices of American and United, the CAB concluded that "CRS owners have a substantial degree of market power over price and output in the CRS industry," and that "CRS carriers are engaged in unfair methods of competition," producing "competitive harms that may be analogous to conduct that would be labeled an abuse of monopoly power under Section 2 of the Sherman Act, 15 U.S.C. § 2." 49 Fed. Reg. 11646, 11647 (Mar. 27, 1984); 49 Fed. Reg. 32540, 32542 (Aug. 15, 1984). Referring to practices employed by American and United, such as excessive subscriber contract terms, exclusive use provisions, and liquidated damage clauses, the CAB concluded that "[t]hese practices appear to entrench vendors and hence preserve market power." Id. at 11665 (Mar. 27, 1984).

Effective November 14, 1984, the CAB adopted a Final Rule designed to address some, though not all, of the anticompetitive abuses employed by American and United. In particular, the Rule (a) prohibited "bias" in the CRS display of flight information; (b) prohibited subscriber contracts with terms in excess of five years; (c) required that system enhancements be provided, if at all, on non-discriminatory terms; and (d) broadly provided that "[n]o system vendor shall directly or indirectly prohibit a subscriber from obtaining or using any other system." 14 C.F.R. §§ 255.4, 255.5, 255.6, 255.7.

Unfortunately, the CAB stopped short of attempting to rectify all of the abuses in the CRS industry that had been brought to its attention, on the ground that "we should as much as possible limit our intervention in the CRS industry and constrain our role to protecting air transportation competition." 49 Fed. Reg. 32540, 32556 (Aug. 7, 1984). In particular, though the CAB expressed concern "about the potential for abuse of liquidated damage clauses," it concluded that "it would be very difficult to devise a liquidated damages formula suitable for all subscriber contracts, given the variety of contracts currently used." Id. In addition, though the CAB resisted appeals to restrict contract terms to periods shorter than five years, it voiced concern over the lack of legitimate business justifications for lengthy contract terms, and expressed the "hope that a shorter term does became the industry standard." Id.

The hopes expressed by the CAB were naive. Shorter contract terms have never materialized; indeed, the five-year maximum became "the industry standard." Liquidated damage clauses in the SABRE and APOLLO agreements were made more, not less, onerous. United and American continued to intentionally bias the SABRE and APOLLO displays in favor of their own flights through secondary bias display, and to use their superior access to the CRS database to retaliate against airline rivals. Perhaps most outrageous, these two dominant CRS vendors used the new Rule as an excuse to abrogate all of their existing agreements with participating carriers, and to replace them with new contracts that substantially increased booking fees. Ironically, the Rule did not give the thousands of small travel agencies who subscribed to SABRE and APOLLO a similar right to escape from their contracts with American and United.

C. Developments after Adoption of the CAB Rule

There is no question that United and American viewed the CAB Rule, and particularly the provision banning display bias, as a threat to the enormous incremental revenues they had been earning from APOLLO and SABRE locations. United challenged the Rule in court, but lost. See United Airlines v. CAB, 766 F.2d 1107 (7th Cir. 1985).

When the court challenge failed, United and American found other ways to preserve their market share and protect against the loss of "incremental revenues," despite the restrictions in the CAB Final Rule.

1. Increased Booking Fees

First, as mentioned previously, both carriers cancelled all existing contracts with airline subscribers and insisted on new agreements which provided for a dramatic increase in booking fees. Participating carriers had no choice but to agree. SABRE booking fees increased from an average of between $.35-$.50 to $1.75 per flight segment for most carriers, and APOLLO fees increased from about the same amount to $1.85. It was estimated in 1985 that these changes increased CRS profits by $99,530,000 for American and $77,550,000 for United, on an annual basis.* The two carriers anticipated that the CAB Rule might reduce the incremental revenues extracted from airline passengers as a result of display bias, and planned to offset that loss by extorting higher booking fees from participating carriers on the SABRE and APOLLO Systems. In fact, United and American also found other ways to bias the CRS displays, and continued to earn incremental revenues.

---

* Study by Dr. William J. Duffy submitted by the joint carrier group to the Aviation Subcommittee of the Senate Committee on Commerce, Science, and Transportation in connection with a March 9, 1985 Hearing on Computerized Reservation Systems.

2. Continuing Display Bias

Though the CAB Rule was effective in eliminating the type of overt display bias that had heavily weighted carrier identity in the display algorithm, American and United found more subtle ways of biasing the SABRE and APOLLO displays, and to continue earning "incremental revenues" in addition to the substantial booking fees. For example, while providing an unbiased "primary" screen showing the flights of all participating carriers, both CRS vendors created "secondary" screens that allowed travel agents to view a display of flights biased in favor of American and United. United also added a feature which permitted the agent to "lock in" the biased display favoring its own flights. A variety of economic incentives were provided to encourage use of the secondary screen. This more ingenious, though no less damaging, form of display bias was apparently eliminated in the spring of 1985, but only as a result of pressure from the Senate Commerce Committee following hearings in March 1985.

American and United then resorted to other forms of display bias. These alternative techniques have had one thing in common: they have involved the use of display criteria that are not explicitly carrier-specific, but in practice favor the flights of the host carrier. A number of examples, of these covert forms of information bias were collected in the 1985 Report of the Department of Justice to Congress on the Airline Computer Reservation System Industry (Dec. 20, 1985) ("1985 DOJ Report"). Perhaps the most damaging to consumers was American's manipulation of "elapsed time" display criteria on routes where it faced direct competition.

A CRS algorithm can be written in such a way as to cause those flights with shorter flying times to appear higher on the display. On its face, this type of "elapsed time" display algorithm is neutral and would appear to provide valuable information for passengers in selecting their flights. American decided to use an elapsed time algorithm in the SABRE system, but made sure that the resulting display would still be biased in favor of its own flights. It did this by routinely entering elapsed flying times for its own flights that matched or undercut the lowest time for competing carriers, without regard to its actual flying times. As a result, American's flights on competitive routes were listed higher in the SABRE display than flights of competing carriers who believed in using actual elapsed time in constructing their schedules. The consumers were again the real losers.

Not only did American's manipulation of the elapsed time algorithm artificially divert passengers toward American's flights and away from more convenient and less expensive offerings by competitors, it also led to an "on-time" problem throughout the industry. Though American had reduced the elapsed time figures that were entered into SABRE, the actual flying time experienced by passengers for the most part remained unchanged. Unfortunately, the elapsed flight times that travel agents reported to their customers were the phony times shown on the SABRE displays, not the true flight times. Not surprisingly, the flights were rarely "on time."

The problem became pervasive after other participating carriers on SABRE eventually discovered American's deception. When American refused to change its reported elapsed times despite complaints from its competitors, the participating carriers had no choice but to reduce their own reported elapsed times in an attempt to achieve parity on the SABRE displays -- again, without a material change in actual time in the air. Eventually, the Department of Transportation was bombarded with consumer complaints about the perceived tardiness of flights. The Department also received a formal complaint by Delta Airlines in June of 1986, which thoroughly documented American's deception. Only after the consumer backlash and pressure brought to bear by the DOT, American announced that it was abandoning its elapsed time fraud. In what can only be characterized as an outrageous display of public relations inventiveness, American claimed credit for responding to the needs of consumers, when its own manipulation of SABRE caused the problem in the first place.

There is considerable irony in the way that American and United responded to the provisions of the CAB Rule which banned display bias. These two carriers used the Rule as an excuse to make dramatic increases in booking fees as a way of offsetting loss of incremental revenues. Then, they proceeded to continue biasing the CRS displays in order to avoid a loss of incremental revenues. The irony is that in this sense the CAB Rule has given the two major CRS vendors a predicate for gouging consumers and competitors worse than ever.

3. Exclusionary Contract Provisions

American and United also took advantage of loopholes in the CAB Rule to adopt additional modifications in travel agency subscriber agreements which have made it more difficult than ever for travel agencies to choose competing CRSs.

Perhaps the most serious of these changes involved a substantial increase in the amount of contractually specified liquidated damages that would be payable upon cancellation of the agreements. Before the CAB Rule was adopted, liquidated damage clauses in the SABRE and APOLLO subscriber agreements provided for payment of all or a substantial portion of equipment rentals that would have been due over the life of the contracts. After adoption of the Rule, American and United increased the liquidated damages by also requiring any agents who cancelled their CRS agreements to pay the estimated booking fees that would have been paid by participating carriers flight segments booked sold by the agency over the life of the contract. Put differently, under current SABRE and APOLLO contracts, American and United insist that converting agents pay, as liquidated damages, not only an amount representing what the agencies would have paid in rentals, but what participating carriers would have paid for segments booked by the agencies.

The amount of such projected lost booking fees can be staggering. To take but one example, a SABRE subscriber with four computer terminals who converted to a different CRS with 42 months remaining on a five-year contract would be required to pay not only projected lost rental charges of $21,840, but "lost" booking fees of $45,158 and a refund of "promotional support" payments of over $65,000, bringing the total "liquidated damages" to over $135,000. Further, each time American raises its booking fees to participating carriers, it automatically increases the severity of these liquidated damages.

In addition to adopting punitive liquidated damage clauses, most of American's 1986 and 1987 SABRE contracts also provide for an automatic renewal of the entire contract term whenever the agency subscriber adds new equipment. Current SABRE contracts have terms of five years (the maximum permitted by the CAB Rule), but the effect of the "rollover" clauses in the SABRE agreements has been to extend the contract term for an additional five years each time new equipment is added to the location, or used to replace existing equipment. Since such additions or replacements occur with regularity in the travel agency industry, the "rollover" clauses have virtually nullified the CAB's rule prohibiting contracts in excess of five years. By insisting on these clauses, American has been able to keep many of its SABRE subscribers hostage for the indefinite future. At the same time, the automatic rollovers have increased the punitive nature of the liquidated damage clauses by increasing the term over which the "lost" booking fees will be projected. United has also followed a practice of insisting on contract extensions as a condition to providing new equipment to its agency subscribers.

It is our understanding that within the last few months, American has announced that it will not enforce rollover clauses in existing contracts in the event of future equipment additions, though it has refused to rescind the automatic extensions that have already occurred. Evidently, American has finally conceded the inherent conflict between its rollover requirements and the CAB Rule, but it has done so only after numerous complaints by SABRE subscribers and considerable pressure from Congress in connection with House consideration of H.R. 3051, the Airline Passenger Protection Act of 1987 (which would have banned rollover clauses). Unfortunately, American's concession in the face of pressure is only partial. It has shown no willingness to rescind the rollover extensions that have occurred to date. Moreover, until Congress legislates a final solution, there is nothing to prevent American from resuming enforcement of the rollover clauses should it decide to do so in the future. Even if American completely renounces these clauses, it will still enjoy the benefit of contract rollovers which have already occurred.

III.

CURRENT CONDITIONS IN THE CRS MARKET

Current conditions in the CRS market are not conducive to competition, and as a result, consumers have been denied the substantial benefits promised by innovation in CRS technology. The industry continues to be dominated by SABRE and APOLLO, and barriers to new entry and expansion are extremely high. Worse still, American and United have continued to pursue policies and practices designed to prevent potential competitors from entering the market, and to keep existing competitors from expanding. Our experience also convinces us that American and United have continued to use their control over the vital CRS information resources to distort competition in the airline industry. Most discouraging, American and United have demonstrated by their actions that they will not end the abuses which plague this industry without intervention by the federal government. Every positive development since 1984, and there have been pitifully few, has come as a direct result of pressure from the Congress and, to a lesser extent, from the Department of Transportation. Without further government intervention to restore fair competition in this market, the prospects for the market improving of its own accord are bleak.

A. Current Barriers to Entry and Expansion

Entry into the CRS market under existing conditions is extremely difficult. Potential entrants who are not air carriers will find it virtually impossible. Some of the entry barriers are inherent in the great cost of establishing a workable system, but many are artificial and have been intentionally erected by the dominant CRS vendors in an effort (so far successful) to preserve their market shares.

The magnitude of entry-level capital investment, though substantial, would not constitute a prohibitive barrier to entry if there were a realistic possibility of earning competitive returns. Unfortunately, artificial barriers to entry have made that possibility decidedly unrealistic. As a result, there have been no new successful entrants into the market since SystemOne and DATAS II in 1981, and MARS-PLUS -- the only entrant that was not owned by an air carrier -- has failed. Moreover, the dominant CRS vendors have used these artificial barriers to deter expansion by their smaller rivals.

The artificial barriers to entry and expansion fall essentially into three categories: (1) contractual barriers to entry; (2) retaliatory litigation and intimidation of travel agencies to prevent their use of competing CRSs; and (3) the need to earn "incremental revenues" to compete on a level playing field with airline CRS vendors.

1. Contractual Barriers to Entry

I have previously described some of the types of contractual barriers to entry that have been put in place by American and United. These consist principally of punitive liquidated damage clauses, excessive contract terms, rollover clauses, and minimum use requirements. The purpose and effect of these arrangements has been to make it exceedingly difficult for new entrants (and existing competitors seeking to expand) to gain travel agency subscribers. Travel agencies who are locked-in to long-term SABRE and APOLLO contracts, many of which have automatically renewed themselves, can choose more attractive rival CRSs only at the risk of being liable for huge liquidated damages. Yet convincing existing CRS subscribers to use a different CRS is virtually the only current means of competing because the market is so heavily saturated. A 1986 Louis Harris survey found that 90% of the nation's travel agencies were already using CRSs (Travel Weekly, June 1986, at 142), and that percentage has grown even larger in the interim.

2. Retaliatory Litigation and Other Intimidation Tactics

Added to these contractual barriers is the serious prospect of litigation for any travel agent considering a change from SABRE or APOLLO. American and United have both made it clear that they will sue travel agencies who switch to rival CRSs before the end of their SABRE and APOLLO contracts. I am aware of 12 different lawsuits by American, and 16 brought by United, against travel agencies who have changed from SABRE and APOLLO to SystemOne. (Four of these suits were brought against travel agencies in Alabama, and one is pending in Utah.) I am aware of 17 other suits that APOLLO and SABRE subscribers have brought themselves in an effort to be released from the bondage of the dominant vendors. Attached to my prepared testimony as Exhibit "C" is a list of these pending cases. In all likelihood, there are other suits that I am unaware of. American and United have filed their suits in an attempt to collect punitive liquidated damages from travel agencies, and to send a deterrent message to the remaining universe of SABRE and APOLLO subscribers that they can do business with the competition only if they are willing to incur the expense and inconvenience of litigation.

In addition to these cases, American has filed a damage suit directly against SystemOne in Fort Worth, Texas, alleging tortious interference with SABRE contracts. American Airlines, Inc. v. Continental Airlines, Inc., et al., Cause No. 153-108286-87 (153rd Dist. Ct., Tarrant County, Tex.). This suit demands $100 million in punitive damages, and is avowedly designed to deter SystemOne from competing against American for the business of travel agencies now held hostage by their SABRE agreements. The irony of this suit is that American has itself induced SystemOne subscribers to convert to SABRE, and has been successful in doing so because SystemOne subscriber agreements do not provide for the punitive liquidated damages which are typical of the SABRE agreements.

There is no question that without government action, American and United will continue to use litigation tactics in an effort to intimidate SABRE and APOLLO subscribers, and to stampede the competition out of the market. SystemOne has the resources to fight against these tactics, but without financial support from their new CRS vendors, many small travel agency businesses face the prospect of ruin if the suits are successful.

Coupled with the severe contractual limitations on agency freedom of choice and the burdens imposed by retaliatory litigation, American has also resorted to other forms of intimidation which have the similar effect of excluding competition. For example, in conjunction with SABRE, American markets a "back office" automated accounting system called ADS. This computerized accounting system is functionally compatible with SABRE and permits the subscriber to automate a number of internal accounting functions. We estimate that ADS currently has approximately 70% of the market for computerized accounting systems in the travel agency industry, and most SABRE subscribers have become dependent on ADS for a large number of routine business activities. It has come to our attention that American has threatened SABRE subscribers considering the use of SystemOne with termination of the ADS service. One travel agency confronted with this threat was forced to bring suit against American in an effort to prevent termination of its ADS access. Ambassador Travel, Inc. v. American Airlines, Inc., Civil Action No. H-87-196 (S.D. Tex., filed Jan. 19, 1987). This overt "tying" of SABRE to ADS imposes a direct restraint on competition in the CRS market, and we suspect that American is increasingly using threatened termination of ADS as yet another means of keeping SABRE subscribers in the American fold.

American and United have also used other means of intimidating their travel agency subscribers not to use competing CRSs. SABRE and APOLLO subscribers who do business with the competition run a number of serious risks, including the loss of override commissions on American and United ticket sales, the inability to obtain "last seat" reservations on American and United flights, and a host of other penalties for being "disloyal" to the dominant vendors. Such threats of injury to small travel agency businesses are not uncommon, and they are taken quite seriously. The business of running a travel agency is not a high-margin enterprise, and incurring the wrath of American or United, particularly in markets where they are the dominant air carriers, can mean the difference between survival and failure. As a result, American and United have been quite successful in bullying many of their CRS subscribers not to use competing systems.

3. The Need to Earn Incremental Revenues

Exclusionary contract clauses and intimidation tactics are not the only means used by the two major CRS vendors to erect barriers to entry and expansion by competitors. Both American and United have continued to use their control over a substantial share of the CRS market to earn incremental revenues. Indeed, preserving the ability to extract such revenues from consumers remains a principal reason to maintain control of the CRS market. New entrants who are not in the airline business, and who therefore, could not earn incremental revenues, would be forced to make the CRS "pay for itself" through booking fees and agency charges alone, and the level of such charges would have to be sufficiently high (without the subsidy afforded by incremental revenues) as to be non-competitive. Existing CRS rivals who have been less aggressive in manipulating their CRSs to earn incremental revenues are under a similar competitive disadvantage.

In sum, it is not surprising that in its 1985 report to Congress, the Department of Justice concluded that "[d]espite the CRS rules, entry or expansion by existing vendors continues to be both costly and uncertain due to new and pre-existing market problems." 1985 DOJ Report, at 21.* Similarly, the General Accounting Office concluded in its May 1986 report on the CRS industry that new entry was "highly unlikely." General Accounting Office, Airline Competition: Impact of Computerized Reservation Systems 9 (May 1986) ("1986 GAO Report").

B. Abuses of Market Power in the CRS Industry

By creating artificial barriers to entry and expansion, American and United have been able to further entrench themselves in the CRS industry and to hinder competition by rivals such as SystemOne. Largely, the efforts of American and United to maintain their lock on the market have been successful. Indeed, the CAB's Final Rule has had little effect on the concentration of power in this market.

In its 1985 report to the Congress, the Justice Department concluded that despite the Rule, "carrier-owned CRSs continue to possess market power," with United and American sharing approximately 70% of all domestic revenue booked by travel agents. 1985 DOJ Report at 2, 17. In May 1986, the GAO also concluded that United and American "have, and are likely to continue to possess, significant market power." 1986 GAO Report at 9. We estimate that American and United currently control over 65% of all sales made through CRS locations nationwide. As I mentioned at the outset, the market shares of American and United in important regional and local markets are much higher than the national average.

---

* In fact, the Department's assessment would have been more bleak but for emergence of another effort to create a so-called "Neutral Industry Booking System" (NIBS). Id. at 28-31, 55-58. That effort has now failed.

These substantial market shares translate directly into market power. In each locality and region where SABRE and APOLLO account for more than a small number of CRS locations, air carriers that operate in those areas have no choice but to enter into participant agreements with American and United in order to have their flights listed on the CRS, and to have an opportunity to sell tickets to passengers whose flights are booked through the CRS. They simply cannot afford to ignore the passengers served by the APOLLO and SABRE subscriber agencies. In areas where United and American are the dominant carriers, the importance of access to SABRE and APOLLO is even more pronounced because those systems account for a huge percentage of travel agency reservations. American and United have attempted to ensure the preservation of their market power by excluding competitors through the use of restrictive contract clauses, tie-ins between the CRS and automated accounting systems, targeted payment of commission overrides, litigation, and threats of injury to the business of agencies considering the use of a different CRS.

1. Increased Booking Fees

American and United have used their power in the CRS market in numerous ways. Booking fees have been raised substantially since the adoption of the CAB Rule. SABRE and APOLLO currently charge $1.85 per flight segment for standard access, and $2.10 per segment for direct access. Booking fees charged by the other CRS vendors are slightly lower, but since the adoption of the 1984 CAB Rule, booking fees throughout the industry have trended toward the levels set by SABRE and APOLLO.

2. Display Bias

Until quite recently, American and United also continued to create display bias, either by designing display algorithms that best serve their own route systems, or by tinkering with the information programmed into the system (e.g., elapsed flight time data). It is unclear at this point whether American and United are continuing to create display bias. There is no question, however, that the listing of flights differs significantly from CRS to CRS, and it is equally clear that control over the CRS continues to translate into increased ticket sales.

To take but one example, albeit an important one: The Denver airline market is extremely competitive, with Continental and United offering a large proportion of available flights. As a percentage of the total number of seats available on Continental and United flights, Continental has 56% and United 44%. In other words, the ratio of Continental seats to United seats in the Denver market is approximately 56:44. Where bookings for flights in the Denver market are made through SystemOne, the comparative percentage of flight segments sold is approximately the same: 56.6% for Continental versus 43.4% for United.* However, where bookings for flights in the Denver market have been made through the APOLLO CRS, 64.2% have been on United flights, versus 35.8% on Continental. In other words, the ratio of Untied sales through APOLLO has been disproportionately larger than the ratio of United seats available in the market.

3. Misuse of Competitive Data

Whether or not United and American are continuing to bias their CRS displays, we do believe that they have continued to use their control over APOLLO and SABRE to enhance their ability to respond to competition in the airline industry. By monitoring the APOLLO and SABRE databases, United and American have access to a wide variety of proprietary data provided by carriers whose flight information is listed in the CRS, including timely information about discount fares and fare promotions, initiation of new service, travel agency activities, passenger travel patterns, frequent flyer program results, and the like. I am aware of several concrete instances in which this access to information has been used to retaliate against rival airlines on competitive routes, and we believe this type of abuse is widespread, though very difficult to identify. For example, a carrier's access to data in its CRS can enable it to analyze the effectiveness of new fare programs marketed by its rivals, and to respond to those initiatives with fare reductions of its own, targeted to the competitive routes that have proven most successful. In addition, access to data accumulated in the CRS can permit the vendor to determine the extent to which its own travel agency subscribers are booking rival flights, versus its own flights. If the vendor concludes that a particular agency has not shown a sufficient commitment to the vendor's own flights, it can bring to bear a combination of threats and inducements that will force the agency back "into line." Both American and United have used their unique access to SABRE and APOLLO data in precisely these ways, in order to gain an edge over competing airlines.

---

* These figures are averages for the months of July through October 1987.

Access to rivals' marketing data can be a useful tool in increasing competition, but only if that access is available to all interested competitors on equal terms. Unfortunately, that is not the case currently, despite the provisions of the CAB Rule requiring nondiscriminatory access to data. See 14 C.F.R. S 255.8. American and United do offer for sale to participating carriers magnetic tapes containing information about each subscriber transaction on the CRS. Nevertheless, American's data is provided only on a monthly basis, and the data is not available until the twentieth day of the following month, by which time much of its value is lost. In addition, access to the data is expensive. United and American charge $10,000 and $12,500, respectively, per month for the data tapes. The data is also produced in "raw" form requiring extensive analysis and expense to make the data useful. The problem is one of equal access on equal terms. With superior access to the data, whether in terms of timeliness, cost, or content, American and United gain an unfair competitive edge over their airline rivals.

4. Deterrence of Airline Expansion

Competition in the airline industry has also been damaged in other ways through the exercise of CRS market power by American and United. Airlines seeking to enter new route systems or to expand their flight offerings on existing routes are often impeded by the control of either United or American over travel agencies in the relevant market, on whom the new or expanding airline entrant must depend for bookings. Ironically, this type of control often continues even after United or American has reduced its presence as an air carrier in the market.

For example, Continental has recently announced the creation of a "mini-hub" at the Cleveland airport, with a substantial expansion of service. United, which has historically had a strong presence in the Cleveland market, has also recently made a substantial reduction in its Cleveland service. Nevertheless, United is still the CRS vendor for 109 of the 150 automated travel agencies in the area, and has shown no intention of permitting those agencies to choose a different CRS despite its substantial exit from the market as an air carrier.

United's continuing control over the great bulk of Cleveland travel agencies will in all likelihood prevent passengers from enjoying the full benefit of Continental's expanded service. Travelers who book their flights through the 109 APOLLO subscribers risk lack of access to up-to-date information about Continental flights; they may be unable to obtain pre-assigned seating and advance boarding passes on those flights; and they may lose access to last-minute seat availability -- all because the APOLLO CRS does not afford complete access to the Continental reservations database. In short, United continues to possess "host advantages" on its CRS, which is dominant in the market, even though United's current flight offerings are now minimal. Cleveland passengers cannot enjoy the full benefit of Continental's expanded service as long as Cleveland travel agencies are indentured to the APOLLO CRS. Yet the APOLLO contracts have been designed to prevent those travel agencies from changing to another, more useful system.

IV.

WHAT BENEFITS CAN BE EXPECTED FROM INCREASED COMPETITION?

As matters now stand, free competition in the CRS market has been restrained by American's and United's use of clauses in the APOLLO and SABRE agreements which deter travel agencies from selecting another CRS, including excessive contract terms, punitive liquidated damage clauses, rollover provisions, and minimum use requirements. Coupled with these exclusionary devices, American and United have resorted to litigation and other forms of intimidation to bully both travel agencies and rival vendors, and to increase the costs of competition. Unless these restraints of trade are halted, there is every reason to believe that United and American will preserve their power in the CRS market, and will continue to use that power in ways that damage travel agencies, rival airlines, and consumers.

Conversely, correcting these market distortions in order to increase fair competition will yield substantial benefits:

First, we believe that increased competition in the CRS market will lead to greater technological innovation in the systems practically available to travel agencies, and that will benefit consumers as well. There is no question that CRS vendors have made substantial investments in computer hardware and software. Yet the incentives for accelerated innovation and improvement have been reduced by the stranglehold that American and United currently have on the market. Rival vendors will think twice about making substantial investments in new technology without a realistic hope that this technology can be successfully marketed to travel agencies. Moreover, American and United themselves have little incentive to introduce improved technology to their subscribers if those subscribers are already locked-in to SABRE and APOLLO. Existing equipment has been partially or fully depreciated, and serves as a maximum source of profits only if it continues to be used. Unless forced by competition to replace outdated equipment, American and United may not have an incentive to do so promptly.

A prime example of this phenomenon is available in the advent of direct access software. Though the technology was available, American and United did not offer it to participating carriers and agency subscribers until after SystemOne introduced it in 1981. They continue to lag behind SystemOne in the use of direct access, and we believe that is due in large part to their desire to maintain informational advantages over competing airlines. Currently, 22 participating carriers are on-line with the direct access feature of SystemOne, and 13 others are under contract to be added to the system with direct access in the near future. SABRE subscribers have direct access to only 16 non-host carriers, and APOLLO subscribers have direct access to only 11.

Second, increased competition should also have a positive effect on the level of CRS charges to travel agencies. If rival CRSs are permitted to sell themselves on the merits, and to expand their penetration of the market, the level of agency charges should become a subject of intense competition and should fall as a result. This would not only benefit travel agencies, but should result in reduced ticket prices as well.

Third, increased CRS competition, coupled with an increase in the level of consumer education and awareness, will deter the types of display manipulation which have plagued both this industry and the airline industry for ten years. Increased consumer awareness of the potential for host carrier abuse of its CRS to favor its own flights will permit more educated consumer choice among flight and service offerings, and among travel agencies. But increased consumer awareness will do little good if display accuracy and timeliness do not become subject to competitive dynamics. For example, SystemOne can attempt to convince travel agencies that the accuracy and objectivity of its displays will benefit their customers and thus benefit them. But if the travel agencies are locked-in to contracts with SABRE and APOLLO, these advantages will not be persuasive reasons to change unless the agencies are willing to endure the prospect of retaliatory litigation. Without increased competition, travel agencies who subscribe to SABRE and APOLLO will increasingly become little more than unwitting exclusive distributorships for American and United flights.

Fourth, increased CRS competition will help prevent future abuses by the two dominant CRS vendors. Events that have transpired since the adoption of the 1984 CAB Rule clearly demonstrate the willingness and ability of American and United to evade government regulation. Both carriers have repeatedly found inventive ways of doing indirectly what the Rule prohibits them from doing directly. In several instances, complaints from consumers, travel agencies, and competing airlines and CRS vendors have generated enough government pressure to bring about some improvement, e.g., American's apparent abandonment of elapsed time display bias and enforcement of rollover clauses. Yet in each instance, the two carriers were able to perpetrate their abuses for considerable periods of time before government pressure was mobilized. There is every reason to expect that this pattern will be repeated in the future.

Vigorous competition is the best antidote to this type of problem. As long as rival CRS vendors are given a fair chance to compete, competition itself will be the best and most efficient means of preventing future abuses, which in any event could not all be anticipated in rulemaking efforts such as the CAB conducted in 1984. Nevertheless, decisive legislative action is needed now to introduce fair competitive conditions.

V.

REMEDIAL MEASURES

In my view, most of the serious problems that beset the CRS industry can be answered by increased competition on a fair basis. The CRS industry is less competitive than it should be, not because the less dominant competitors are not willing and able to do the job, but because American and United have made competition as difficult as possible in order to reap monopoly profits from their entrenched positions.

I also believe that these restraints on competition must be attacked at their source -- by forbidding the use of liquidated damage clauses and excessive subscribers terms. The key to competition is freedom of choice, and domestic travel agencies are not free to choose as long as they are hostage to their SABRE and APOLLO contracts. If American and United are fearful of competition, the solution that will best serve the public interest is to give them a reason to improve what they offer. The solution they have chosen is to deny their rivals the fair chance to sell what they offer.

VI.

CONCLUSION

I would again like to express my thanks to the Subcommittee for the opportunity to appear at these hearings, and to encourage the Members to act decisively in dealing with the serious problems that these hearings will disclose. The CRS market will not right itself. More aggressive action by the Department of Transportation is needed to curb violations of the letter and spirit of the CAB Rule, and remedial legislation is needed to deal with the exclusionary contracts that have been put in place by the dominant CRS vendors.

Thank you.

EXHIBIT A

CRS LOCATIONS BY STATE

	SABRE	APOLLO	SYSTEMONE	PARS	TOTAL
Alabama	56 (35%)	58 (36%)	44 (28%)	2 (1%)	160
Alaska	89 (67%)	43 (33%)	0 (0%)	0 (0%)	132
Arizona	273 (56%)	67 (14%)	62 (12%)	89 (18%)	491
Arkansas	74 (84%)	12 (14%)	0 (0%)	2 (2%)	88
California	2019 (43%)	1612 (35%)	224 (5%)	774 (17%)	4629
Colorado	160 (24%)	360 (53%)	107 (16%)	48 (7%)	675
Connecticut	319 (56%)	85 (15%)	121 (22%)	41 (7%)	566
Delaware	7 (21%)	2 (6%)	0 (0%)	24 (73%)	33
Florida	483 (24%)	207 (10%)	1330 (64%)	47 (2%)	2067
Georgia	89 (17%)	120 (23%)	303 (59%)	4 (1%)	516
Hawaii	134 (38%)	213 (60%)	5 (2%)	1 (0%)	353
Idaho	28 (31%)	59 (65%)	0 (0%)	4 (4%)	91
Illinois	636 (41%)	642 (42%)	128 (8%)	132 (9%)	1538
Indiana	141 (40%)	113 (33%)	34 (10%)	59 (17%)	347
Iowa	24 (17%)	98 (70%)	0 (0%)	19 (13%)	141
Kansas	45 (27%)	33 (19%)	0 (0%)	92 (54%)	170
Kentucky	59 (44%)	19 (14%)	38 (28%)	18 (14%)	134
Louisiana	114 (46%)	60 (24%)	62 (25%)	14 (5%)	250
Maine	32 (54%)	26 (44%)	0 (0%)	1 (2%)	59
Maryland	152 (41%)	133 (35%)	64 (17%)	26 (7%)	375
Massachusetts	581 (53%)	203 (22%)	200 (18%)	113 (10%)	1097
Michigan	364 (47%)	328 (42%)	59 (8%)	31 (4%)	782
Minnesota	248 (51%)	72 (15%)	131 (27%)	34 (7%)	485
Mississippi	25 (44%)	24 (42%)	7 (12%)	1 (2%)	57
Missouri	86 (15%)	50 (9%)	145 (25%)	289 (51%)	570
Montana	53 (77%)	10 (14%)	0 (0%)	6 (9%)	69
Nebraska	26 (19%)	71 (54%)	23 (16%)	15 (11%)	140
New Hampshire	101 (80%)	12 (10%)	0 (0%)	13 (10%)	126
New Jersey	419 (38%)	250 (22%)	304 (27%)	149 (13%)	1122
New Mexico	58 (41%)	17 (12%)	15 (11%)	51 (36%)	141

CRS LOCATIONS BY STATE (Cont'd)

	SABRE	APOLLO	SYSTEMONE	PARS	TOTAL
New York	1494 (50%)	567 (19%)	592 (19%)	355 (12%)	3008
Nevada	29 (16%)	72 (41%)	39 (22%)	37 (21%)	177
North Carolina	59 (21%)	136 (47%)	89 (31%)	3 (1%)	287
North Dakota	29 (66%)	8 (18%)	0 (0%)	7 (16%)	44
Ohio	248 (29%)	373 (43%)	100 (12%)	139 (16%)	860
Oklahoma	156 (59%)	30 (11%)	18 (7%)	61 (23%)	265
Oregon	67 (22%)	195 (63%)	36 (12%)	13 (4%)	311
Pennsylvania	228 (20%)	330 (29%)	354 (31%)	235 (20%)	1147
Rhode Island	45 (25%)	35 (19%)	88 (48%)	15 (8%)	183
South Carolina	19 (11%)	43 (26%)	102 (62%)	1 (1%)	165
South Dakota	9 (30%)	19 (63%)	0 (0%)	2 (7%)	30
Tennessee	170 (62%)	66 (24%)	34 (13%)	2 (1%)	272
Texas	1263 (70%)	201 (11%)	290 (16%)	52 (3%)	1806
Utah	63 (37%)	79 (47%)	12 (7%)	15 (9%)	169
Vermont	23 (57%)	12 (30%)	0 (0%)	5 (13%)	40
Virginia	183 (32%)	170 (30%)	191 (34%)	23 (4%)	567
West Virginia	6 (55%)	0 (0%)	0 (0%)	5 (45%)	11
Washington	172 (29%)	325 (54%)	66 (11%)	34 (6%)	597
Wisconsin	161 (36%)	202 (46%)	56 (13%)	22 (5%)	441
Wyoming	14 (33%)	27 (64%)	0 (0%)	1 (3%)	42
Washington DC	165 (35%)	113 (24%)	163 (35%)	30 (6%)	471
Puerto Rico	120 (33%)	0 (0%)	245 (66%)	3 (1%)	368

EXHIBIT B

CRS LOCATIONS BY CITY

	SABRE	APOLLO	SYSTEMONE	PARS	TOTAL
Akron/Canton	16 (25%)	35 (55%)	13 (20%)	0 (0%)	64
Albany	16 (39%)	5 (12%)	18 (44%)	2 (5%)	41
Albuquerque	33 (33%)	8 (8%)	15 (15%)	45 (44%)	101
Allentown	9 (8%)	56 (50%)	42 (38%)	5 (4%)	112
Amarillo	13 (93%)	0 (0%)	0 (0%)	1 (7%)	14
Anchorage	53 (70%)	23 (30%)	0 (0%)	0 (0%)	76
Atlanta	71 (16%)	79 (18%)	280 (65%)	2 (1%)	432
Austin	95 (80%)	13 (11%)	7 (6%)	3 (3%)	118
Baltimore	44 (25%)	64 (36%)	64 (36%)	5 (3%)	177
Baton Rouge	17 (71%)	7 (29%)	0 (0%)	0 (0%)	24
Billings	8 (62%)	5 (38%)	0 (0%)	0 (0%)	13
Birmingham	23 (43%)	10 (18%)	21 (39%)	0 (0%)	54
Bismarck	6 (100%)	0 (0%)	0 (0%)	0 (0%)	6
Boise	2 (6%)	28 (88%)	0 (0%)	2 (6%)	32
Boston	345 (41%)	215 (26%)	200 (24%)	78 (9%)	838
Buffalo	22 (30%)	14 (19%)	36 (49%)	1 (2%)	73
Casper	1 (11%)	8 (89%)	0 (0%)	0 (0%)	9
Cedar Rapids	0 (0%)	36 (95%)	0 (0%)	2 (5%)	38
Charleston, SC	9 (24%)	6 (16%)	23 (60%)	0 (0%)	38
Charlotte	19 (19%)	10 (10%)	71 (71%)	0 (0%)	100
Chicago	372 (38%)	401 (41%)	128 (13%)	83 (8%)	984
Cincinnati	57 (65%)	25 (28%)	0 (0%)	6 (7%)	88
Cleveland	20 (10%)	105 (54%)	65 (33%)	5 (3%)	195
Columbus	29 (31%)	7 (8%)	22 (24%)	34 (37%)	92
Colorado Spgs	13 (24%)	30 (55%)	3 (6%)	8 (15%)	54
Columbia	0 (0%)	9 (24%)	29 (76%)	0 (0%)	38
Corpus Christi	24 (83%)	1 (3%)	4 (14%)	0 (0%)	29
Dallas/ Fort Worth	562 (88%)	44 (7%)	24 (4%)	9 (1%)	639
Dayton	3 (8%)	7 (19%)	0 (0%)	27 (73%)	37

CRS LOCATIONS BY CITY (Cont'd)

	SABRE	APOLLO	SYSTEMONE	PARS	TOTAL
Daytona Beach	5 (20%)	2 (8%)	18 (72%)	0 (0%)	25
Denver	99 (19%)	286 (55%)	107 (20%)	31 (6%)	523
Des Moines	4 (9%)	39 (85%)	0 (0%)	3 (6%)	46
Detroit	221 (51%)	137 (32%)	59 (14%)	12 (3%)	429
El Paso	32 (78%)	3 (7%)	6 (15%)	0 (0%)	41
Evansville	7 (35%)	7 (35%)	6 (30%)	0 (0%)	20
Fargo	6 (55%)	0 (0%)	0 (0%)	5 (45%)	11
Ft. Lauderdale	39 (15%)	18 (7%)	200 (77%)	4 (1%)	261
Fort Meyers	12 (16%)	10 (13%)	54 (71%)	0 (0%)	76
Freseno	1 (3%)	32 (82%)	0 (0%)	6 (15%)	39
Gainesville	6 (19%)	1 (3%)	25 (78%)	0 (0%)	32
Grand Junction	1 (8%)	11 (92%)	0 (0%)	0 (0%)	12
Grand Rapids	8 (26%)	22 (71%)	0 (0%)	1 (3%)	31
Great Falls	4 (80%)	0 (0%)	0 (0%)	1 (20%)	5
Greensboro	4 (8%)	14 (27%)	34 (65%)	0 (0%)	52
Greenville	1 (2%)	8 (13%)	50 (83%)	1 (2%)	60
Hartford	44 (38%)	19 (17%)	43 (37%)	9 (8%)	115
Honolulu	103 (32%)	211 (66%)	5 (1%)	1 (1%)	320
Houston	286 (47%)	102 (16%)	222 (36%)	18 (1%)	628
Huntsville	4 (19%)	2 (10%)	15 (71%)	0 (0%)	21
Indianapolis	70 (48%)	16 (11%)	28 (19%)	31 (22%)	145
Jackson	4 (24%)	6 (33%)	7 (41%)	0 (0%)	17
Jacksonville	40 (36%)	37 (32%)	37 (32%)	0 (0%)	114
Kansas City	11 (2%)	27 (12%)	108 (46%)	94 (40%)	240
Knoxville	7 (19%)	14 (40%)	14 (40%)	1 (1%)	36
Lafayette	10 (71%)	4 (29%)	0 (0%)	0 (0%)	14
Las Vegas	16 (13%)	40 (34%)	29 (24%)	35 (29%)	120
Lincoln	1 (5%)	15 (79%)	0 (0%)	3 (16%)	19
Little Rock	25 (69%)	10 (28%)	0 (0%)	1 (3%)	36
Long Beach	84 (67%)	14 (11%)	0 (0%)	27 (22%)	125
Louisville	29 (36%)	5 (6%)	38 (47%)	9 (11%)	81
Los Angeles	862 (44%)	650 (33%)	137 (7%)	303 (20%)	1,952
Madison	13 (42%)	18 (58%)	0 (0%)	0 (0%)	31
McAllen	7 (78%)	2 (22%)	0 (0%)	0 (0%)	9

CRS LOCATIONS BY CITY (Cont'd)

	SABRE	APOLLO	SYSTEMONE	PARS	TOTAL
Melbourne	2 (6%)	0 (0%)	32 (94%)	0 (0%)	34
Memphis	42 (67%)	20 (32%)	1 (1%)	0 (0%)	63
Miami	122 (20%)	24 (4%)	463 (75%)	9 (1%)	618
Midland	14 (100%)	0 (0%)	0 (0%)	0 (0%)	14
Milwaukee	31 (16%)	103 (51%)	56 (28%)	11 (5%)	201
Minneapolis	101 (32%)	62 (20%)	131 (42%)	19 (6%)	313
Minot	5 (100%)	0 (0%)	0 (0%)	0 (0%)	5
Missoula	4 (100%)	0 (0%)	0 (0%)	0 (0%)	4
Mobile	13 (62%)	0 (0%)	8 (38%)	0 (0%)	21
Nashville	52 (51%)	30 (30%)	19 (19%)	0 (0%)	101
New Haven	79 (46%)	10 (6%)	78 (46%)	4 (2%)	171
New Orleans	49 (30%)	39 (24%)	62 (38%)	12 (8%)	162
New York	1,077 (50%)	299 (14%)	481 (23%)	277 (13%)	2,134
Newark	172 (28%)	116 (19%)	304 (49%)	23 (4%)	615
Norfolk	10 (14%)	9 (13%)	50 (70%)	2 (3%)	71
Oklahoma City	54 (59%)	13 (14%)	15 (17%)	9 (10%)	91
Omaha	12 (13%)	48 (53%)	23 (25%)	8 (9%)	91
Orlando	28 (22%)	27 (21%)	70 (56%)	1 (1%)	126
Pensacola	4 (13%)	3 (9%)	25 (78%)	0 (0%)	32
Philadelphia	94 (19%)	117 (23%)	213 (43%)	76 (15%)	500
Phoenix	183 (55%)	50 (15%)	47 (14%)	53 (16%)	333
Pittsburgh	39 (14%)	95 (34%)	99 (36%)	43 (16%)	276
Portland	34 (15%)	153 (69%)	26 (12%)	9 (4%)	222
Providence	16 (12%)	16 (12%)	88 (69%)	9 (7%)	129
Raleigh/Durham	12 (9%)	70 (50%)	55 (40%)	2 (1%)	139
Rapid City	2 (50%)	2 (50%)	0 (0%)	0 (0%)	4
Reno	7 (21%)	17 (50%)	10 (29%)	0 (0%)	34
Richmond	15 (15%)	16 (16%)	70 (69%)	0 (0%)	101
Rochester	37 (44%)	12 (14%)	36 (42%)	0 (0%)	85
Sacramento	34 (40%)	40 (46%)	0 (0%)	12 (14%)	86
San Juan	118 (33%)	0 (0%)	240 (66%)	3 (1%)	361
Salt Lake City	47 (37%)	57 (45%)	12 (9%)	12 (9%)	128
San Antonio	72 (62%)	12 (10%)	24 (20%)	9 (8%)	117
San Diego	147 (53%)	95 (34%)	11 (4%)	24 (9%)	277

CRS LOCATIONS BY CITY (Cont'd)

	SABRE	APOLLO	SYSTEMONE	PARS	TOTAL
San Francisco	321 (37%)	270 (32%)	73 (9%)	192 (22%)	856
San Jose	53 (29%)	95 (51%)	3 (2%)	34 (18%)	185
Sarasota	22 (29%)	7 (9%)	45 (60%)	1 (2%)	75
Savannah	2 (7%)	6 (19%)	23 (74%)	0 (0%)	31
Seattle	95 (21%)	277 (60%)	66 (14%)	22 (5%)	460
Sioux Falls	2 (25%)	6 (75%)	0 (0%)	0 (0%)	8
Spokane	11 (28%)	29 (72%)	0 (0%)	0 (0%)	40
St. Louis	39 (17%)	19 (9%)	37 (17%)	128 (57%)	223
Syracuse	19 (43%)	3 (7%)	21 (48%)	1 (2%)	44
Tallahassee	11 (50%)	0 (0%)	11 (50%)	0 (0%)	22
Tampa/St. Pete	38 (11%)	45 (13%)	251 (75%)	2 (1%)	336
Tucson	53 (51%)	15 (14%)	15 (14%)	21 (21%)	104
Tulsa	50 (56%)	22 (24%)	3 (3%)	15 (17%)	90
Washington, DC	302 (49%)	113 (18%)	163 (26%)	40 (7%)	618
West Palm Beach	23 (17%)	15 (11%)	99 (71%)	2 (1%)	139
Wichita	6 (12%)	13 (25%)	0 (0%)	33 (63%)	52

EXHIBIT C

SUMMARY OF PENDING TRAVEL AGENCY CASES

Ambassador Travel, Inc. v. American Airlines, Inc.
(S.D. Tex. 1/19/87)

American Airlines, Inc. v. Anchor Travel Services, Inc.
(N.D. Tex. 9/1/87)

American Airlines, Inc. v. Arbor Travel
(Tex. Dist. Ct., Dallas County 8/26/87)

American Airlines, Inc. v. Castles in the Sky
(N.D. Tex. 6/8/87)

American Airlines, Inc. v. Colpitts Travel Center of Syracuse, Inc.
(N.D. Tex. 9/1/87)

American Airlines, Inc. v. Holiday Travel, Inc.
(Tex. Dist. Ct., Dallas County 9/1/87)

American Airlines, Inc. v. Holiday Travel Service, Inc.
(N.D. Tex. 3/13/87)

American Airlines, Inc. v. Manhattan Travel
(N.D. Tex. 9/1/87)

American Airlines, Inc. v. Sunset Travel
(N.D. Tex. 9/1/87)

American Airlines, Inc. v. Travel Corp.
(N.D. Tex. 9/1/87)

American Airlines, Inc. v. Travel Town, Inc.
(N.D. Tex. 4/7/87)

American Airlines, Inc. v. Woodlake Travel Service, Inc.
(Tex. Dist. Ct., Dallas County 6/26/87)

American Airlines, Inc. v. World Express Travel, Inc.
(Tex. Dist. Ct. Dallas County 5/20/87)

Arbor Travel, Inc. v. American Airlines, Inc.
(S.D. Tex. 9/24/87)

Clark's Apparel, Inc. d/b/a Clark's World Travel v. United Airlines, Inc.
(S.D. Fla. 10/6/87)

Holiday Travel, Inc. v. American Airlines, Inc.
(S.D. Tex. 8/20/87)

Scotties Tours 'N' Travel v. American Airlines, Inc.
(S.D. Tex. 10/26/87)

Sunrise Travel, Inc. v. United Airlines, Inc.
(S.D. Fla. 10/6/87)

Sunset Travel, Inc. v. American Airlines, Inc.
(S.D. Fla. 9/23/87)

TK Travel v. American Airlines, Inc.
(C.D. Cal. 10/27/87)

The Travel Corp. Inc. v. American Airlines, Inc.
(S.D. Fla. 10/6/87)

United Airlines, Inc. v. Aladdin Travel Agency, Inc.
(N.D. Ala. 6/4/87)

United Airlines, Inc. v. Austin Travel Corp., et al.
(S.D.N.Y. 2/26/87)

United Airlines, Inc. v. Braley Tours and Travel, Inc. d/b/a Trans Air Travel
(S.D. Tex. 10/5/87)

United Airlines, Inc. v. Clark's Apparel, Inc., d/b/a Clark's World Travel
(Utah Dist. Ct., Utah County 6/6/87)

United Airlines, Inc. v. Discount Travel Service
(N.D. Ala. 6/19/87)

United Airlines, Inc. v. Four Seasons Travel
(N.D. Ala. 6/4/87)

United Airlines, Inc. v. Key Travel, Inc.
(Nebraska Dist. Ct., Douglas County 9/16/87)

United Airlines, Inc. v. Mid States Travel, Inc.
(Nebraska Dist. Ct., Douglas County 9/16/87)

United Airlines, Inc. v. Protea Travel, Inc.
(D. Hawaii 7/19/87)

United Airlines, Inc. v. Robinson Travel, Inc.
(D. Hawaii 6/12/87)

United Airlines, Inc. v. Travel Express, Ltd.
(D. Hawaii 9/24/87)

United Airlines, Inc. v. TV Travel-Rockbrook, Inc.
(Nebraska Dist. Ct., Douglas County 9/16/87)

United Airlines, Inc. v. Twickenham Travel
(N.D. Ala. 6/19/87)

United Airlines, Inc. v. Vincent's Travel Agency, Inc.
(Colorado Dist. Ct., El Paso County 5/13/87)

United Airlines, Inc. v. Wilson Travel Service, Inc.
(Missouri County Ct., Jackson County 9/2/87)

United Airlines, Inc. v. World Travel Service of Kansas City
(Nebraska Dist. Ct., Douglas County 9/16/87)

Vacations Unlimited v. United Airlines, Inc.
(S.D.N.Y. 10/9/87)

Vincent's Travel Agency v. United Airlines, Inc.
(S.D. Fla. 10/6/87)

Woodlake Travel Service, Inc. v. American Airlines, Inc.
(S.D. Tex. 9/8/87)

World Express Travel v. American Airlines, Inc.
(S.D. Tex. 9/24/87)

Senator **Metzenbaum**. Thank you very much, Mr. Murray.

Mr. **Murray**. Thank you.

Senator **Metzenbaum**. The Chair has some questions, but first, before offering those questions, I wanted to say how pleased I am that the ranking minority member of this committee has joined us, Senator Strom Thurmond. He has indicated that he has an opening statement and he wants it included in the record, and it will be included in the record immediately following the Chair's opening statement.

Mr. Buckman, one issue in this whole debate is whether the CRS rule has gotten rid of bias in flight listings. Last year, Delta complained to the Department of Transportation that after the rule took effect, American allegedly resorted to sham schedules based on phony elapsed times to retain its position on the top line of the CRS screen.

Appearing on the top line, as I understand it, can be worth millions in additional bookings. Exhibits to Delta's complaint reproduced on the charts that are here show how American, by allegedly reducing the elapsed time of a Dallas-Ft. Worth/Ontario flight, recaptured the critical top line in the SABRE display.

I intend to question Mr. Scocozza, of DOT, on this later, but I want to ask you, how do you explain this, and was Delta's complaint totally frivolous?

Mr. **Buckman**. Senator, in responding, I think that we have responded to the DOT on this same concern. The modification or the adjustment of schedule times is not something that is of—

Senator **Metzenbaum**. I cannot hear you well. Will you get closer?

Mr. **Buckman**. Yes, sir. Is that better?

The modification of schedule times, as part of a competitive industry, especially in the airline industry, is not something new, and this has occurred long before CRS's were ever in existence. Back in the 1950s, schedules associated with transcon services related to prop jet services versus the new 707's actually had flight services that were shown with schedule times that were perhaps shorter than the actual elapsed time. This is not something that we consider to be related to the CRS business, but is part of the competitive airline industry, and it has historically been apparent that even in the days when the OAG was used as a primary source of schedule services, that times reflecting somewhat less than what might be expected on all days of operation, were shown in the OAG in order to achieve a better appearance or a higher ranking within that document.

We have said that our attempts in this area, as American Airlines, were to match those schedules of our competitors and the times that they have shown in these markets—and the specific example that you have here—the modification that occurred was to reduce the elapsed time for the American services to match that of Delta.

Senator **Metzenbaum**. To what?

Mr. **Buckman**. To match that of Delta.

Senator **Metzenbaum**. But do I understand you then to admit that airlines, and particularly yours, because you can only speak for yours, do use artificial schedule times as a marketing device?

Mr. BUCKMAN. I think we are saying that the use of schedule times be similar to that offered by our competitors, given that a flight may operate at a different time for the different conditions on every day of the week, so that they, the consumers, are able to estimate exactly what time it may actually be. It is going to change from one day to another, but the use of times that reflect what the anticipated arrival time of the schedule is something that has been a competitive issue within the industry for many years.

Senator METZENBAUM. Well, what is the answer to my question?

Mr. BUCKMAN. Sir, I am not the scheduling person within American to determine that. I just say——

Senator METZENBAUM. You are speaking for American, so give me an answer, would you please?

Mr. BUCKMAN. I am speaking for American——

Senator METZENBAUM. Is it not a fact that your airline—and I do not know about others—at times uses artificial arrival and destination times in order to secure competitive—for whatever reason?

Mr. BUCKMAN. Sir, in answering your question, I would say that certainly our posture to use competitive schedule times, the term artificial is not something that I think I would feel comfortable in saying that, as saying that is what we do, no. I think——

Senator METZENBAUM. You have competitive times and sometimes those competitive times are unrealistic, is that it?

Mr. BUCKMAN. That is something that we have been very outspoken about and encouraging DOT to adopt a policy of eliminating elapsed time from the parameters utilized in ordering CRS displays, and that has been adopted now, so there is no longer an encouragement for airlines to use reduced schedule time in their operation or in order to achieve a higher display within the CRS systems, thus improving the quality of service that is provided the customers.

I think over the last 6 months one of the things that has been achieved with the elimination of elapsed times in the determination of the ordering of the displays, has been the reduction of the encouragement for carriers to use reduced schedule times in order to improve their display in the systems.

Senator METZENBAUM. Texas Air claims that American and United are not providing equal access to market intelligence generated by their CRS systems, despite the CRS rule requiring them to do so. It says, for example, that American does not make the data available until much of its value is lost, and then in the meantime you are taking full advantage of the data at its expense. Is there any truth to that charge, and, if not, why?

Mr. BUCKMAN. No, sir, Senator, I do not believe that is the case. As a result of the CAB rule, we are required to provide the marketing data that is produced by the system to the other carriers. This data is produced on a monthly basis, it is the sum of the purged passenger reservation records that are done on a nightly basis, and collected on a monthly tape. It is provided to the carriers that wish to pay the cost that we incur in order to provide that information to them. That is one element of the information that we certainly provide. It is the same type of information that our people use. The people that use that reservation data have to wait a month after that period is closed before they have access to that information within our company, and I think there are a couple of additional things that need to be said about that.

In some of the testimony that has been provided, it is indicated that we use this information for the determination of override payments. The fact is that this information is not used in determining override payments. That would be a violation of the CRS rules that were issued by the CAB. We actually, in fact, use the information based upon the lift of tickets issued by agencies in determining that, and if this booking data was valuable and so important, it is interesting to me that only three carriers currently choose to purchase that data from us.

Senator METZENBAUM. Do I understand—let me just get a simple answer—is the market intelligence data that is developed by your system——

Mr. BUCKMAN. Yes.

Senator METZENBAUM [continuing]. As readily available to other airlines as it is to your airlines?

Mr. BUCKMAN. Yes, sir. We do not provide that data to our people other than a month after the fact, after that tape is collected.

Senator METZENBAUM. And as rapidly as your own people get it?

Mr. BUCKMAN. It is fair to say that it is within a matter of a day or two, yes. I mean that tape is produced, it is raw data that is given to our system and in a similar fashion as the data is provided to the other carriers. We have to take and process it through a number of different programs and software to produce the information in a format that our people want to use it.

We just said that we do not think we want to presume how the other carriers might like to see that data, in what format and in what structure, so we have provided all the data for them to choose and select what information they might like to have.

Senator METZENBAUM. And why is there a day or two delay?

Mr. BUCKMAN. I am sure it is for the production of the tapes and the shipment. I am not that familiar with the process. I can certainly provide that as far as supplementary information to the committee.

Senator METZENBAUM. I get the impression from your testimony that you think competition is working beautifully in the CRS business, and that nothing needs to be done to make it better. You say, for example, that booking fees are not anticompetitive. The non-CRS carriers who pay these fees disagree, and I understand DOT is looking at this issue now.

Let us suppose DOT finds that booking fees are excessive and decides something needs to be done. What should that something be, in your opinion?

Mr. BUCKMAN. Well, sir, as we said, we do not think that anything does need to be done. If DOT makes some determination that booking fees need to be adjusted, then I think it may have some impact in the structure of this industry. Certainly, as the largest system in this business, we feel like we are the lowest cost producer of information. If those fees are reduced, it may have an impact on actually the competitive nature of this business as other vendors may not be able to generate satisfactory incomes in order to justify the continued existence of their systems.

Senator **METZENBAUM**. Mr. Kotar, let me preface my comments by saying to you that I think we in Congress will decide what is appropriate and what is not appropriate for us to get into. While I respect your right to believe that Congress should not be in this area, I think we in the Congress will make that determination for ourselves.

I am frankly disturbed, Mr. Kotar, by reports that United is making it extremely hard for travel agents in Cleveland to switch CRS vendors, despite the fact that it has drastically cut its Cleveland service. The head of the Travel Agents Association Mid-America Chapter describes, for example, how APOLLO recently prevented a small Ohio agent from switching by rolling over the agent into a new 5-year contract when it added a new printer to its APOLLO system. He also describes how contract terms are generally being forced upon small travel agents, limiting their ability to switch systems.

Is it not a fact, Mr. Kotar, that APOLLO and other CRS vendors make it very hard for travel agents to switch? Does that not make it harder for a CRS vendor to expand its business and increase competition?

Mr. **KOTAR**. Before I answer the question, my comment relative to the appropriateness of this——

Senator **METZENBAUM**. Bring it a little closer, please. Speak up.

Senator **THURMOND**. Speak into the microphone so that we can hear you, if you would.

Mr. **KOTAR**. Yes, sir. My comment relative to the appropriateness of this committee's looking into the subject was only a function of timing. Obviously, this committee will do whatever it so chooses.

What we are saying is that, given the legislative and the judicial actions that are coming forth, particularly the judicial, we think that it should take time to play out before any actions would take place, sir.

Senator **METZENBAUM**. How many years has this matter been before the CAB and the DOT and the courts?

Mr. **KOTAR**. I believe it began in 1983.

Senator **METZENBAUM**. It is only 4 years at this point, and we are ending the year 1987, and we will soon be into 1988.

Mr. **KOTAR**. Yes.

Senator **METZENBAUM**. And you still think we ought to just sit by and let——

Mr. **KOTAR**. What I am saying, sir, is that the rules by the CAB were promulgated in 1984 and we do not believe that they have had time—we believe that in fact the rules are being lived up to.

Senator **METZENBAUM**. That the rules what?

Mr. **KOTAR**. That the rules are being lived up, the relative points there on bias, on providing marketing information, et cetera, have all been dealt with, and the other issues relative to liquidated damage and the like are being at this point in time looked at in the courts, and all we are saying is that it is a function of timing before the courts resolve those issues.

Relative to the question at hand, I cannot speak to the specific case in point. The one point you made was relative to a rollover clause, where somebody added a printer and in fact the contract was extended. That particular clause was eliminated from CRS agreements within the past 6 months. It is no longer in effect, and we would not look to enforce it for any contracts that were in effect prior to that. It was not put into effect for purposes of limiting competition, it was put into the contract for the purposes of as much allowing the CRS vendors to handle their contractual work on an on-going basis.

Relative to the specific question of Cleveland, are we making it difficult for agents to move from one system to another: Generally speaking, we have 5-year agreements with our agents.

Senator METZENBAUM. You have what?

Mr. KOTAR. Five-year contractual term agreements with our travel agents. Those agreements include provisions that are negotiated on both sides, both parties agree to certain actions that they will live up to during the term of that agreement, and once those agreements are terminated at the end of that 5 years, that customer is free to move to any other system.

Senator METZENBAUM. My question concerned whether the small Ohio agent was prevented from switching by being rolled over into a new 5-year contract when it added a new printer to its APOLLO system. Is there something about the right to extend the contract when you make some change?

Mr. KOTAR. But that is the provision that I said has been deleted from the agreements within the last——

Senator METZENBAUM. Has what?

Mr. KOTAR. Has been deleted as a standard provision in our contractual agreements within the last 5 years.

Senator METZENBAUM. This man said that it happened recently. United only cut its service to Cleveland rather recently. When did you delete it?

Mr. KOTAR. Within the last few months, sir, I do not know the specific date.

Senator METZENBAUM. Can this travel agent get out of your contract, then, retroactively?

Mr. KOTAR. I would have to look at the case in point, sir, and come back with a report to this committee.

Senator METZENBAUM. Please do that, and let me hear from you.

Mr. KOTAR. I will. If I can have any further specific information as to the account, it would help.

Senator METZENBAUM. Thank you.

Mr. Murray, you have been seeking legislation to make it easier for travel agents to switch CRS vendors so that other CRS vendors such as SystemOne can expand, yet American claims in its testimony that expansion is easy. With 1,500 to 2,000 new travel agents annually entering the business, American also says SystemOne grew from around 5,300 to around 6,800 agencies, or about 22 percent in the past year. Does American have a point, or is it just playing with numbers? And exactly how hard has it been for SystemOne to pick up new travel agent business?

Mr. MURRAY. I believe that they are playing with the numbers. The increase in subscribers in 1987 and even in the prior year has been in large measure due to new entrants, that is new travel agencies or existing travel agents establishing branch offices, about 75 percent, as a matter of fact, of that volume was comprised of that type of location. Twenty-five percent or less of the locations were actually travel agents who have switched from other systems.

Senator METZENBAUM. American claims that the present rule permitting CRS travel agent contracts up to 5 years is reasonable and that mandating a shorter duration would simply result in a higher cost for CRS service. They indicate that the 5-year rule is consistent with the normal kind of contract and that there is no reason to change it. Do you have any views on that subject?

Mr. MURRAY. I have some very strong views. Again, with the existence of the liquidated damages, the punitive damages, the expense is enormous——

Senator METZENBAUM. What is the size of those punitive damages?

Mr. MURRAY. They can range—we had some examples that we had prepared. In the case of a travel agency, taking a comparison with SABRE, this is a travel agency that generates annual gross passenger revenues of just under a million dollars, with four video display units and two printers and 42 months remaining on the term of the agreement, the liquidated damage portion dealing with the overall bookings fee recovery would be $45,158.40. There is an additional refund of the promotional support which would be compounded annually at 10 percent from the date of receipt of such support, which would amount to $68,023, so that in the case in point the aggregate cost for that travel agency to terminate the agreement and obligations to American would be $135,622.

Senator METZENBAUM. And what would you guess that travel agent would generate in gross income for the agency?

Mr. MURRAY. Well, in gross income, perhaps $150,000.

Senator METZENBAUM. Gross income in its share of the sale, is that what you are saying?

Mr. MURRAY. Yes. Well, it would be based upon the commission revenues, Mr. Chairman, that they would receive from the carriers and the other vendors.

Senator METZENBAUM. Mr. Kotar, let me ask you, would United be willing to change their liquidated damage clause to provide that in a contract termination, the travel agent would be required to pay actual damages, and that if there were a dispute as to the amount of those actual damages, the matter could be arbitrated?

Mr. KOTAR. I would suggest, sir, at this time we would say that we would prefer to keep the contract—we believe that the way our contracts are constructed for determining the value of the liquidated damages is a minimal amount that we should expect as a fair compensation should someone choose to abrogate an agreement, considering the investment, so my answer to you would be no.

Senator METZENBAUM. Why would you not agree to just getting your actual damages?

Mr. KOTAR. Where we are coming from, sir, is the fact that we believe that the actual damages, which include the lease cost of the equipment, communication costs and support costs, et cetera, and we believe that the on-going costs for transaction fees are something that are part of our real costs. Furthermore, we believe the way we stated the agreement, it is a minimum amount that we should expect, and then we believe also that the courts is where, if there is any dispute, rather than going into arbitration, that the courts are the best places to adjudicate that.

Senator **Metzenbaum**. So that the case can drag out longer and the poor travel agent has to pay high fees, lawyer fees, that United and American can afford to pay and he cannot?

Let us first get to the basic point. Would you be willing to give the travel agent the right to terminate based upon your actual damages, including such matters as you just mentioned, if those are actual damages?

Mr. **Kotar**. We do that today, sir. Any agent who chooses to terminate an agreement, we send them a bill based upon the value as determined on the contract and the term of the contract that is left, and we send them a bill——

Senator **Metzenbaum**. I understand that——

Mr. **Kotar** [continuing]. And we expect them to pay.

Senator **Metzenbaum** [continuing]. But I am not asking you about how you send them a bill. I am not asking you about the liquidated damage clause. I am asking you simply would your United be willing to permit the travel agent to terminate the contract, provided that United was compensated for its actual damages? That takes a yes or no answer.

Mr. **Kotar**. The answer is yes, we do that today. It is no different than——

Senator **Metzenbaum**. The answer is yes, you would?

Mr. **Kotar**. Yes, including as long as the liquidated damages would include——

Senator **Metzenbaum**. I did not say liquidated damages, sir. There is a difference between liquidated damages and actual damages. Liquidated damages is where you provide——

Mr. **Kotar**. I understand.

Senator **Metzenbaum** [continuing]. You may provide a million dollars to cancel a contract. I am talking about actual damages. Now, that takes a yes or no answer.

Mr. **Kotar**. Yes, we would, provided actual damages would include the determination that we have talked about, yes.

Senator **Metzenbaum**. Provided actual damages include what?

Mr. **Kotar**. Include those elements that we talked about, which would include the lease fees, the maintenance fees, as well as transaction fees.

Senator **Metzenbaum**. That is a question for someone other than a United States Senator to determine, as to what actual damages are.

Mr. **Kotar**. Yes.

Senator **Metzenbaum**. But you would be willing to permit termination by payment of actual damages?

Mr. **Kotar**. Yes, we do today.

Senator **Metzenbaum**. And is that also the position of American, Mr. Buckman?

Mr. **Buckman**. Yes.

Senator **Metzenbaum**. I have no further questions of these witnesses.

Senator Thurmond?

Senator **Thurmond**. Thank you, Mr. Chairman.

Senator METZENBAUM. And I want to tell you, I apologize for taking this long to go through all of the witnesses, and please take as much time as you need.

Senator THURMOND. All right.

Mr. Buckman, you made several allegations in your prepared testimony concerning improper conduct by Texas Air. Have any of these activities resulted in lawsuits, and, if so, what has been the results.

Mr. BUCKMAN. Senator Thurmond, the conduct that is referenced in my testimony relates to Texas Air's applying of their airline leverage or the use of overrides and airline related incentives in order to encourage an agency to convert to SystemOne. That type of activity is specifically prohibited in the CAB rules, the CRS rules of 1984. We have indeed appealed and filed a complaint with the DOT. In the case of some agencies that have converted from the system and have breached the contracts, we have also filed suit. None of those cases, to my recollection, have been resolved.

Senator THURMOND. You note in your testimony——

Mr. BUCKMAN. Excuse me, Senator. In addition, we have sued Texas Air for tortious interference in those contracts.

Senator THURMOND. I cannot hear you.

Mr. BUCKMAN. We have also sued Texas Air for tortious interference involving those contracts.

Senator THURMOND. Do not drop your voice, because we want to hear you and we want the audience to hear you.

Mr. BUCKMAN. Yes, sir.

Senator THURMOND. You note in your testimony that more than 750 SABRE automated agents have CRS's of other vendors in the same location. What is the advantage of having a dual installation?

Mr. BUCKMAN. Sir, we do not see that there is a significant advantage to having a dual installation. Perhaps it is to provide coverage for system outage, if there happens to be a communications problem, so the agency has an alternative source to go and obtain information. There also may be a limited amount of information that may be available in the other system that is not available in our system. That is very much the exception, rather than the rule. And given the fact that we provide both direct access and multiaccess capabilities to the other major CRS systems, there is no need to have a second CRS system, because a subscriber of SABRE can, for example, go into SystemOne or can have access to the information of APOLLO without having an APOLLO terminal.

There is a desire on the part of some of those agencies to have access to another system, to be able to represent in their marketing activities to their clients and to potential customers that they have more than one system in their office. We truly do not believe there is that much value to it.

Senator THURMOND. Are you aware of any cases in which the liquidated damage provision or any other provision of your CRS contract has been struck down or specifically upheld?

Mr. BUCKMAN. No, sir, Senator, none of them have reached the decision stage, to my knowledge.

Senator THURMOND. Mr. Kotar, are you aware of any cases in which the liquidated damage provision or any other provision of your CRS contract was struck down or specifically upheld?

Mr. KOTAR. In one case in Virginia——

Senator THURMOND. Speak up so that we can hear you now.

Mr. KOTAR. Yes, sir. In one case tried in the State of Virginia, in the Federal District Court, the United Air Lines suit was upheld and liquidated damages were found in favor of United Air Lines——

Senator THURMOND. You must not drop your voice, we cannot hear you.

Mr. KOTAR. Excuse me, sir—and the fact is that the case was found for United Air Lines and liquidated damage provisions were upheld.

Senator THURMOND. You state in your prepared testimony that there is a complicated mix of factors that contribute to an increased United share of airline transportation and not simply the fact that United's CRS system is in a travel agency. Could you please elaborate on those factors?

Mr. KOTAR. First and foremost is the airline relationship with the agency. Generally speaking, when an airline receives a higher than expected share of business, a lot of that would be due to the fact that they would have employees of the airline calling on that agency and the relationship develops, as well as the fact that airlines do offer incentives to travel agents to sell more of their business, and they can be in the form of dollars, cash, or what we call soft dollars which are other incentives which we believe are the primary reasons why airlines receive higher than expected share of revenues.

Senator THURMOND. Despite your statement that bias has been totally eliminated from computer reservation systems by DOT regulations, others continue to suggest that bias does exist. Why is there inconsistent testimony on this point, and what kind of bias could they be referring to?

Mr. KOTAR. Senator, when you have to order a display, be it the schedule display, a fare display, et cetera, on the computer, there have to be certain factors that go into determining what logic would be used for display of that information, and each system has slightly different logic as to how that information should be displayed.

In the case of United Air Lines, we believe we reflect what consumers prefer, so if you look at the United displays between any two points, any two cities, you would first see non-stop and direct flights displayed in sequential order, beginning from the time requested, and then you would reflect connecting flights, and those flights are handled in that fashion.

In American Airlines, they intermix their non-stop and direct flights with their connecting flights. We also reflect elapsed flying time in our displays for determining ordering, and American recently eliminated elapsed flying time, so there are different criteria that are utilized by the various CRS vendors in determining ordering the display, and because of that some people feel that there could still be considered some bias utilized.

Senator THURMOND. Has your market share increased in the last couple of years.

Mr. KOTAR. I'm sorry, sir?

Senator Thurmond. Has your market share increased in the last couple of years?

Mr. Kotar. Market share of the CRS products, sir?

Senator Thurmond. Yes.

Mr. Kotar. Yes, COVIA has up until this year and it is now declining.

Senator Thurmond. Now, I want to ask you one question I asked Mr. Buckman. Are you aware of any cases in which the liquidated damage provision or any other provision of your CRS contract has been struck down or specifically upheld?

Mr. Kotar. I believe that is the same question I referred to first, sir, where we had a case in the Federal District Court in Virginia that was upheld for United Air Lines. There have been no cases that have been adjudicated against United.

Senator Thurmond. I want to ask Mr. Murray that same question.

Mr. Murray. Senator, I am not aware of any instances regarding upholding or struck down. We have 20 cases pending.

Senator Thurmond. Mr. Murray, you heard my question about market share. Would you care to answer that question?

Mr. Murray. The question relating to SystemOne's experience in market share?

Senator Thurmond. Yes.

Mr. Murray. Yes, sir. We believe we have experienced roughly a 3 percentage point increase in revenue market share, and approximately 8 percentage points in location share.

Senator Thurmond. There is a vote on and that was the 5-minute bell and I am going to have to leave. Senator Metzenbaum will be back in a few minutes, so we will take a recess for about 5 minutes.

[Short recess.]

Senator Metzenbaum. The subcommittee will come to order.

I just have one or two more questions. Mr. Buckman, does your CRS display automatically show the cheapest flight?

Mr. Buckman. No, Senator. The way our display is structured today is based upon scheduled services and the fare information is not integrated within the schedule display or the availability display.

Senator Metzenbaum. And how about you, Mr. Kotar?

Mr. Kotar. People generally ask for the flight first and once they ask——

Senator Metzenbaum. Pardon?

Mr. Kotar. People ask for the flight information first. Once we have the flight request, then we can go and determine what the fare would be, and based on that we determine what the availability is by class of service, then we would quote from the lowest fare available, so it is a sequential series of steps that have to occur.

Senator Metzenbaum. But it does not automatically come up on the screen, is that what you are saying?

Mr. Kotar. It cannot is what I am saying. Without knowing the specific request of the flight and class of service, how could it give you a fare?

Senator Metzenbaum. How can the consumer be sure that the travel agent is telling him the least expensive flight available?

Mr. KOTAR. How can the consumer?

Senator METZENBAUM. Yes.

Mr. KOTAR. It depends on the honesty of the travel agent. They are business people and their ability to get business is based on providing people the best level of service based on the customer request. Obviously they are successful, they sell 80 percent of the business.

Senator METZENBAUM. Mr. Buckman, the same question, sir?

Mr. BUCKMAN. I would concur with Mr. Kotar's remarks and just add that, given that there is close to 30,000 travel agencies in this business, it is also a very competitive business from their side and if they are not successful in satisfying their customer and giving the customer the impression that they are providing them accurate information, then they certainly stand a big chance to lose that customer.

Senator METZENBAUM. Mr. Buckman, first: I want to get clear whether or not you would be willing to accept termination rights based upon actual damages, rather than liquidated damages. And as far as the definition of what actual damages are, that is an issue to be determined either by the judge, the jury, or an arbitrator.

Mr. BUCKMAN. Sir, we would be willing to accept actual damages. In fact, we have offered that to subscribers that have wanted to settle their contracts with us. So as defined by the judge or the courts, we would accept actual damages.

Senator METZENBAUM. You would accept actual damages?

Mr. BUCKMAN. Yes, sir.

Senator METZENBAUM. And you, Mr. Kotar?

Mr. KOTAR. Yes, as we previously said, sir——

Senator METZENBAUM. Pardon?

Mr. KOTAR. As we previously stated, we would be willing to accept actual damages determined by some court, some other party.

Senator METZENBAUM. All right. Mr. Murray, I just asked you a couple of questions and I feel that I do not want to preclude you if you are bursting with some piece of information you want in the record before we conclude this panel and I want to give you an opportunity to do so. Is there anything that you feel you have not had an opportunity to say, Mr. Murray?

Mr. MURRAY. Just one point, Mr. Chairman, I would like to amplify on, and it relates in part to your question addressed to the other witnesses relative to the consumer and how information may be obtained for all airlines through their CRS system.

I believe that a major issue that has not been focused on, and we would strongly encourage this committee or the Department of Transportation to focus on, is the distinct advantage that a CRS carrier vendor does have over any other airline, we believe that there are some specific rules that could be implemented that would greatly benefit both the travel agency and the consumer, as well as those airlines who do not have CRS systems, and I am referring about the training, about the functionality, if you will, of the capabilities of the systems to access information in other airline systems.

One answer that might be given to the question that you asked regarding the consumer being assured of the lowest fare is not only the consumer asking or emphasizing the desire for the lowest fare, but then the travel agency being able not only to interrogate the existing CRS host system that they have installed, but as well to be able to access information that may reside in other carrier systems with which to provide the answer.

Senator Metzenbaum. Thank you very much, Mr. Murray. Thank you, Mr. Kotar. Thank you, Mr. Buckman.

Mr. Buckman. Senator, could I make one correction to the transcript that was provided? There is data that is indicated in my testimony that states that there has been between 1,500 and 2,000 new agencies formed every year. That number should be 2,500 to 3,000.

Thank you.

Senator Metzenbaum. Thank you.

Our second panel consists of a single individual representing the United States Government, Mr. Matt Scocozza, Assistant Secretary for Policy and International Affairs, Department of Transportation.

Mr. Scocozza, we are very happy to have you here before our committee. You have appeared before and have been very helpful. Please proceed. We do have a 5-minute rule, but since you are representing the government, we might go way out of our way and get it up to 7 minutes or something like that, but try to be as brief as you can.

STATEMENT OF MATTHEW V. SCOCOZZA, ASSISTANT SECRETARY FOR POLICY AND INTERNATIONAL AFFAIRS, U.S. DEPARTMENT OF TRANSPORTATION

Mr. Scocozza. Thank you very much, Mr. Chairman. I will be brief. I will stay within your 5-minute rule.

Once again, I would like to personally thank you for letting me make my presentation later in the day. I have a very, very longstanding commitment and I appreciate you being able to help me accommodate that engagement.

Senator Metzenbaum. We are happy to have you with us, sir.

Mr. Scocozza. And the extended testimony will be provided for the record, with your permission.

While CRS's are an indispensable component of the air travel industry, they have also been used in the past to adversely affect airline competition. The Department is currently engaged in a study of the CRS industry.

Mr. Chairman, your staff has asked me to address certain questions relating to booking practices, booking fees, barriers to entry, incentive programs, access to marketing data, CRS and airline market concentration and divestiture.

Given that our study has not been completed, I am afraid that I will not be able to answer your questions in detail, but I will be responsive as best I can, given the information available.

As to booking practices, there is no question but that every vendor believes that it will receive additional business if an agent adopts its system, although there is no clear answer on whether the vendor-subscriber relationship is more important in influencing booking patterns than commission overrides, which can be offered by all airlines and targeted to high-volume agents.

Display bias in booking practices consists of arranging flight information shown on the CRS display, so what appears to be objective information really favors the CRS vendor's flights. In the past, vendors did have CRS display rules which tended to favor their own flights. Voluntary action by the vendors and new rules by the Department have, we believe, effectively eliminated overt display bias.

Senator METZENBAUM. Are those rules in effect?

Mr. SCOCOZZA. They are, Mr. Chairman.

Senator METZENBAUM. They are?

Mr. SCOCOZZA. They are.

A great deal of concern has also been expressed that the level of booking fees may have long-term adverse implications for competition in the airline industry. We are in the process of completing our analysis of the profitability of the various CRS's. After we have completed our research, we will be in a better position to assess what action, if any, the Department should take regarding booking fees.

On the question of entry barriers, Mr. Chairman, each vendor, except Delta, incorporates liquidated damages in some form in its current standard contract. Clauses providing for recovery of lost booking fees are clearly the most controversial. As noted, the Department will be reviewing the nature of the contractual relationships between vendors and agents, as well as the outcome of pending court cases, to determine if our rules governing this relationship should be modified.

Incentive programs come into play when travel agents receive volume incentives, that is, override commissions from airlines. To some degree, these commissions can be used to overcome any excessive influence a CRS vendor has over a subscribing agent or to promote entry into new markets, thus these commissions can, enhance competition in the sale of air transportation.

However, some parties have claimed that a vendor can use override commissions to deter competition by other CRS vendors and to enhance its CRS market position. The Department will be examining this claim in its study.

I think it is important to remember that there are approximately 29,000 travel agents and that there is intense rivalry among agents for customers, competition that compels agents to meet their customers' travel needs.

Mr. Chairman, under the Department's CRS rules, each vendor is required to make available to all participating carriers on nondiscriminatory terms all marketing, booking and sales data that it elects to generate from its system.

With regard to the question of divestiture, I think we should proceed with extreme caution. Competition among vendors for agents has encouraged them to invest hundreds of millions of dollars in computer software and other system enhancements. One must question whether these same incentives would exist if CRS systems were divested from their airline owners.

That concludes my prepared remarks, Mr. Chairman, and I would be delighted to answer any questions.

[The prepared statement of Mr. Scocozza follows:]

TESTIMONY OF MATTHEW V. SCOCOZZA, ASSISTANT SECRETARY FOR POLICY AND INTERNATIONAL AFFAIRS, UNITED STATES DEPARTMENT OF TRANSPORTATION, BEFORE THE COMMITTEE ON THE JUDICIARY, SUBCOMMITTEE ON ANTITRUST, MONOPOLIES AND BUSINESS RIGHTS, DECEMBER 10, 1987

Good morning, Mr. Chairman, and Members of this Subcommittee. It is a pleasure to appear before you today. The topic of today's hearing is competition between the airline-owned computer reservation systems (CRSs) and the effect of these systems on competition in the airline industry.

A computer reservation system consists of a central database, periodically updated, which is accessed by subscribers, who are primarily travel agents, through computer terminals. The major component of a CRS is one or more mainframe computers that process messages received from travel agents, city ticket offices, and the airlines' internal reservation personnel. These messages are relayed to the central computer. By prompting a computer keyboard, the user is able to review, on successive screens, up-to-date information on air fares, rules, schedules, seat availability, and other non-airline services. Travel agents generally lease the necessary computer terminal and ticketing equipment from a vendor, establishing a contractual relationship between the vendor and the subscriber. There is also a contractual relationship between the vendor and airlines that choose to have information about their fares and services displayed in a CRS. In short, CRSs provide subscribers with information on airline fares and services and allow them to make reservations and issue tickets.

The CRS industry is composed of five major vendors -- SABRE, APOLLO, PARS, SYSTEMONE, and DATAS II. These systems are controlled by several large air carriers -- American, Allegis, TWA/Northwest, Texas Air, and Delta. Their growth and increasing technological sophistication over the last decade has been truly phenomenal. In my view, two factors are primarily responsible for the increasing role of CRSs in the air travel industry. First, deregulation has brought forth a proliferation of fare and service offerings. Computers are really the only way this vast amount of rapidly changing information can be made available in a cost-effective manner to agents and the traveling public. Second, computer technology has continued to develop at a rapid rate, thereby increasing the capability of computers to store, process, update, and retrieve large amounts of data quickly and efficiently.

Travel agents value CRSs because they increase their productivity and lower the costs of doing business. The benefits of operating CRSs are overwhelming: According to a recent survey, 97 percent of ASTA-accredited agents are now automated.

While CRSs are an indispensable component of the air travel industry, they have also been used in the past to adversely affect airline competition. As a result, the Civil Aeronautics Board adopted rules to govern the CRS industry and prevent the CRS vendors from using their market power to restrict or distort competition in the airline industry. The Department of

Transportation is responsible for monitoring the CRS industry and for ensuring that vendors comply with these rules. We are, of course, prepared to take any remedial action necessary to ensure that competition in the airline industry is preserved.

The Department is currently engaged in a study of the CRS industry. Our study focuses on the following issues: (1) the fees paid by participating airlines and the relationship of these fees to the vendors' costs; (2) the extent to which "incremental" revenues accrue to CRS vendors*; (3) the vendors' market shares in major metropolitan markets; and (4) the competitive effects of the liquidated damages provisions and other clauses in agency contracts. In preparing our report, we have, unfortunately, encountered problems in processing and interpreting the vast amount of data the vendors have made available to us. These problems have now been largely overcome, and we expect to have our study completed early next year.

The Department has not reached any conclusions as to what actions, if any, we should take regarding the CRS industry. Only after our report has been completed, thoroughly reviewed within the Department, and circulated for comment to other agencies and interested parties, will we be in a position to decide if our analysis justifies the Department's further involvement in the CRS industry.

---

*Incremental revenues are the additional revenues a vendor airline receives because a travel agent subscribes to its CRS. Incremental revenues have two components: (1) the "halo" effect, which is the additional business a vendor airline receives because of its business relationship with the agent, and (2) display "bias," which is the distortion of flight information to advantage the vendor airline's flights.

Mr. Chairman, your staff has asked me to address certain questions relating to "booking practices," "booking fees," "barriers to entry," "incentive programs," "access to marketing data," "CRS and airline market concentration," and "divestiture." Given that our study has not been completed, I am afraid that I will not be able to answer your questions in detail, but I will be responsive as best I can given the information available.

Booking Practices: There is no question every vendor believes that it will receive additional business if an agent adopts its system, although there is no clear answer on whether the vendor-subscriber relationship is more important in influencing booking patterns than commission overrides, which can be offered by all airlines and targeted to high-volume agents. We are in the process of conducting statistical tests that will provide us with more information on whether, and, if so, to what extent and why, agents book a disproportionate share of their customers on the vendor airline.

I doubt whether most airline passengers are aware that the CRSs operated by their travel agent are owned by an airline, although I am not certain that if this information were made available to the travelers it would have any major impact on reducing whatever market power the vendors may possess or the ability of agents to favor one airline over another.

The issue of display bias in booking practices consists of arranging flight information shown on the CRS display so what appears to be objective information really favors the CRS vendor's flights. In the past, vendors did have CRS display rules which tended to favor their own flights. While each vendor now ranks flights in a slightly different manner, voluntary action by the vendors and new rules issued by the Department and the CAB have, we believe, effectively eliminated overt display bias. Even in the absence of carrier-specific bias, the possibility of a carrier's exploiting display ranking criteria to secure an advantage through deception requires our vigilance. For instance, due to the priority given to display of on-line connections over interline connections, flights listed under a single, shared code are more likely to be brought to a customer's attention than others listed under the codes of the carriers actually providing service. The Department's rules specify appropriate forms of public notice to ensure that customers will be aware of the nature of the services offered.

Another source of concern is the incentive to publish unrealistic schedules generated by the use of elapsed flight time in display ordering. At our suggestion, the vendors have agreed to eliminate this factor in ranking nonstop flights, and we are negotiating to secure its removal for connecting flights.

Booking Fees: A great deal of concern has been expressed that the level of booking fees may have long-term adverse implications for competition in the airline industry. The argument is generally made that excessive booking fees result in non-vendor airlines' transferring substantial amounts of money to vendor airlines. It is alleged that over time, the effect of this transfer will weaken the non-vendor airlines' financial condition, which would result in less vigorous airline competition. On the other hand, some carriers have been financially successful and remained vigorous competitors without owning a CRS. We are currently in the process of completing our analysis of the profitability of the various CRSs. After we have concluded our research, we will be in a better position to assess what action, if any, the Department should take regarding booking fees.

Barriers to Entry: The vendors devote considerable resources to retaining, recruiting, and converting agents to their CRSs. In fact, in certain large metropolitan markets vendors are engaged in "conversion wars." Also, the smaller vendors -- SYSTEMONE, PARS, and DATAS II -- have made major commitments to upgrading the capability of their systems and acquiring new subscribers. Vendors frequently buy agents out of their existing contracts, and they have compensated agents for the financial liabilities incurred because of the liquidated damages provisions in their contracts. More recently, some vendors have offered to finance the legal cost of challenging these contracts in court.

Liquidated damages clauses are regularly included in commercial contracts, and they are honored if they are a reasonable estimate of potential damages from a breach. However, if the amount is excessive or otherwise unreasonable, the clause may be considered a penalty, and a court will not enforce it.

Each vendor except Delta incorporates liquidated damage clauses in some form in its current standard contract. The clauses provide for recovery of three basic types of damages: payment of lost subscriber fees; repayment of considerations or incentives given to induce the agent to convert to its system or renew its CRS contract; payment of lost booking fees. Not all vendors incorporate all three types into their clauses. Clauses providing for recovery of lost booking fees are clearly the most controversial.

The controversy over liquidated damage clauses in subscriber contracts involves the inclusion of lost booking fees as an element of damages. Booking fee provisions lead to high liquidated damage payments by subscribers; payments for lost booking fees can exceed payments for lost subscriber fees. Moreover, the provisions require the subscribers to pay vendors for fees the vendor would have earned from participating airlines.

As you know, Mr. Chairman, several cases have been brought in state courts which will determine whether certain provisions in these contracts are legal. To the best of my knowledge, the question of whether these "lost" booking fees are reasonable compensation for a breach of contract has not been decided by any court.

Formerly, the major vendors automatically renewed an agent's five-year contract whenever any change was made to the number of terminals or the type of equipment the agent operated. Quite recently, several vendors have acted to eliminate their "rollover" provisions, which I view as a very positive development. As noted, the Department will be reviewing the nature of the contractual relationship, as well as the outcome of pending court cases between vendors and agents to determine if our rules governing this relationship should be modified.

Incentive Programs: I doubt whether most air travelers are aware that travel agents receive volume incentives, i.e., override commissions, from airlines. To some degree, these commissions can be used to overcome any excessive influence a CRS vendor has over a subscribing agent or to promote entry into new markets. In some respects, override commissions can enhance competition in the sale of air transportation. However, some parties have claimed that a vendor can use override commissions to deter competition by other CRS vendors and to enhance its CRS market position. The Department will be examining this claim in its study.

While an airline pays override commissions to encourage agents to select its flights over those of its competitors, I think it is important to remember that there are approximately 29,000 travel agents, and that there is intense rivalry among agents for customers. This competition compels agents to meet their customers' travel needs and to provide them with satisfactory information.

Access to Marketing Data: Under the Department's CRS rules, a vendor is required to make available to all participating carriers on non-discriminatory terms all marketing, booking, and sales data that it elects to generate from its system. While some non-vendor airlines argued that the marketing data supplied by the vendors was unusable when it was first offered for sale, it is my impression that the vendors and participating airlines have resolved any differences they had regarding these data. If this is not the case, the Department will carefully review any complaint alleging that a vendor is not complying with this provision of our CRS rules.

CRS and Airline Market Concentration: While many parties argue that ownership of a CRS is essential for long-run survival in the airline industry, I believe these claims are excessive. However, I would like to point out that opportunities to own a part of a CRS are available to any carrier that believes CRS ownership is critical. According to press reports, TWA/Northwest will consider offers from other carriers to acquire a portion of PARS, and Allegis will consider selling up to 50 percent of APOLLO.

Divestiture: With regard to the question of divestiture, I think we should proceed with extreme caution. CRS technology has progressed at a rapid rate. Competition among vendors for agents has encouraged them to invest hundreds of millions of dollars in computer software and other system enhancements. In addition, airline ownership of CRSs may produce efficiencies because CRSs have equipment, facilities, and personnel with their owners' internal reservation departments. A decision to require divestiture should be made only after careful evaluation of the likely effect of divestiture on efficiency and CRS owners' incentives to continue to improve their systems. It is useful to remember a conclusion reached by DOJ in its 1985 Report to Congress on the CRS industry: "Although we cannot quantify the effects, it is clear that the costs of various divestiture alternatives are very high, and the possibility of service disruption is great."* Also, it is important to remember that even divestiture of CRSs from their airline owners would not necessarily eliminate the need for some regulation over these systems.

Mr. Chairman, this concludes my prepared remarks. I will attempt to answer your questions.

---

*U.S. Department of Justice, 1985 Report of the Department of Justice to Congress on the Airline Computer Reservation System Industry, December 20, 1985, p. 75.

Senator METZENBAUM. Thank you, Mr. Scocozza.

Let me ask you this question: How long has this issue been before the Department of Transportation?

Mr. SCOCOZZA. Well, officially we inherited the responsibility from the Civil Aeronautics Board in January of 1985. We instituted a study approximately a year ago.

Senator METZENBAUM. So that it will be 3 years that you have had it, besides the time that the CAB had it?

Mr. SCOCOZZA. Yes.

Senator METZENBAUM. And still there is no resolution of the issue?

Mr. SCOCOZZA. Well, a number of issues were resolved, Mr. Chairman, without rulemaking early on in our succession to the CAB functions. For example, in January of 1985, a very, very emotional issue at the time was the primary-screen versus secondary-screen bias question. Carriers were concerned that screens were ostensibly biased in favor of the vendor owner.

We were able to get a voluntary agreement by all vendors to eliminate the secondary-screen, which was the biased screen. There was a strong feeling on the House side and the Senate side at the time that we should perhaps initiate a rulemaking proceeding. I believe the voluntary agreement we were able to reach in the spring of 1985, was able to end-run what would have been a 1-year regulatory process which would have cost the carriers a tremendous amount of money and not benefited consumers during the pendency of the rulemaking.

Senator METZENBAUM. Earlier, I inquired of United and American about the right of a travel agency to elect to pay actual damages instead of liquidated damages, and my question to you is would the DOT be receptive to providing leadership to bring about that change?

I am aware of the fact that the first answer from the United representative indicated that that would have to include loss of future booking fees, but in his second answer he did not include that qualification, and to me the issue is actual damage fees as determined by an arbitrator, a judge or a jury.

Would the Department of Transportation be inclined to provide leadership in bringing about that kind of an option for travel agents?

Mr. SCOCOZZA. It is not in my prepared statement, the longer statement, but you asked a direct question and I will give you a direct answer. The Department has seen excessive liquidated damages costs. I would be remiss if I did not state that right at the outset.

We saw as particularly onerous the rollover provisions.

Senator METZENBAUM. The what?

Mr. SCOCOZZA. The rollover provisions, under which at the end of your 5th year on a contract, if an extra computer was added, or an extra console, you had to suffer through another 5-year commitment. Fortunately, those provisions have been erased voluntarily, although I believe there is a question whether it has been erased by one of the vendors, and I do not have up-to-date information on that particular situation. But there is a point beyond which liquidated damages are excessive, and there is no question about the fact that we are prepared to work with the carriers, the vendors, and the travel agencies. I would indicate, Mr. Chairman, that travel agents have not been vocal before the Department of Transportation, and I would hope that your hearing today would encourage that very, very important part of this equation to voice their opinions before the Department and before Congress.

In 1985, when we were trying to decide the question of secondary-screen bias, there was a noticeably absent voice, that of the travel agents. Individual agencies themselves gave us their opinions and their thoughts and they were very helpful, but I would really encourage their trade associations to be active in the exercise before us.

Senator METZENBAUM. Mr. Scocozza, earlier I questioned American about a Delta complaint filed with DOT in June 1986 alleging that American continued to bias its SABRE displays by publishing sham elapsed times for some of its flights after the anti-bias rule took effect.

My understanding is that the Department of Transportation never took action on this particular complaint, although you do say in your prepared statement that you have gotten CRS vendors to agree to stop this practice for non-stop flights. How long after the Delta complaint did you obtain this agreement, and when do you expect to extend it to all flights?

Mr. SCOCOZZA. It was substantially after the filing of the Delta complaint. However, Mr. Chairman, when we got the Delta complaint about American Airlines, I think it would be difficult for any airline to say that it was not practicing unrealistic scheduling. That was the reason for the consumer rule initiated by the Department. We felt that the problem was widespread and we had to take care of it in an across-the-board fashion.

As a matter of fact—and I am not pointing fingers at any one particular carrier—both Delta and American were found to have been practicing unrealistic scheduling. Now, to the point that it was also put in the CRS's is a reflection of the Official Airline Guide publications as well, which we also believe were unrealistic.

Senator METZENBAUM. Have you done anything to correct that?

Mr. SCOCOZZA. We have seen a tremendous change toward more realistic scheduling by carriers, across the board. We have a consumer rule now which has substantial penalties and fines, and we have also prosecuted six carriers. I should not use the word "prosecution," it was a civil forfeiture, it was a consent order entered into between the Department and six carriers, Delta and American included, that agreed to more realistically reflect their scheduling, and we are monitoring their systems as a whole on a weekly basis.

Senator METZENBAUM. What are these consumer protection rules that you just mentioned?

Mr. SCOCOZZA. These are the rules that we announced recently, Mr. Chairman, requiring the publication of on-time performance, so that market forces would encourage carriers to more realistically represent their schedules.

Senator METZENBAUM. I have one more question. The CRS vendors just recently increased their booking fees to non-CRS carriers, even though the Department of Transportation is currently studying whether the old fees were too high. I understand that Pan Am and perhaps some other carriers asked the Department to get the CRS vendors to agree to halt their fee increases until the department has finished its study. That request frankly seems quite reasonable to me. It seems premature to raise these fees right before the Department of Transportation finds, as it may, that the prior fees were already too high. What does the Department of Transportation intend to do about that?

Mr. SCOCOZZA. Mr. Chairman, we chose not to intervene, because our study was not complete and we thought it would be inappropriate for us to make a conclusion about the appropriateness of fees in the private sector.

I would note that out of all of the vendor systems that we are studying, one is not making money and is charging a fee comparable to other vendors who are doing very well. In light of such information, we felt it would be inappropriate to step in.

There will be some alarming results that come out of our study. Some people may say, that raising your fees at a time when the fees are in question to begin with may be like digging a hole and burying yourself. I think that, in light of the study that is going on, in light of the scrutiny and the reviews that are going on in this House as well as the House of Representatives, it is probably unwise for carriers which clearly have been making a high profit on their booking fees to be raising fees at this time, but we have no governmental authority to go in and ask them to change. The atmosphere was not conducive to asking them to reduce their fees. If we had, it would have fallen upon deaf ears. I cannot make judgments for the carriers. They did what they felt they had to do.

Senator METZENBAUM. You have no authority to do what?

Mr. SCOCOZZA. We have no authority to tell them to change their fees or to freeze their fees. We do have the authority, Mr. Chairman, to regulate fees, but we would have to enact regulations setting up criteria and ratemaking programs which are not in place. The Civil Aeronautics Board chose not to do so.

Senator METZENBAUM. Do you want Congress to give you additional authority?

Mr. SCOCOZZA. It is not a question of additional authority. We do have the statutory authority, but before we touched the CRS's, we would first have to put in place a regulatory mechanism.

Senator METZENBAUM. Senator DeConcini, any questions or an opening statement?

Mr. DECONCINI. Mr. Chairman, I have no questions of this witness. I do have an opening statement, Mr. Chairman, but in light of the fact that time is moving along here, I will ask that it be inserted in the record.

Senator METZENBAUM. Your statement will be made a part of the record.

[The prepared statement of Senator DeConcini follows:]

STATEMENT OF SENATOR DENNIS DeCONCINI
COMPUTER RESERVATION SYSTEMS
ANTITRUST SUBCOMMITTEE
DECEMBER 10, 1987

MR. CHAIRMAN, I WANT TO THANK YOU FOR CALLING THIS HEARING TODAY ON THIS IMPORTANT ISSUE. THIS IS A VERY BUSY TIME IN THE SENATE, AND IN THE JUDICIARY COMMITTEE IN PARTICULAR. DURING THE NEXT FEW WEEKS MILLIONS OF AMERICANS WILL BE TRAVELING USING OUR COMMERCIAL AIRLINES. IT IS APPROPRIATE DURING THIS TIME THAT THE SUBCOMMITTEE EXAMINE THE MANNER IN WHICH THE TRAVELING PUBLIC GAINS ACCESS TO THE AIRLINES.

OUR PASSENGER AIR TRANSPORTATION SYSTEM TODAY IS CHARACTERIZED BY USE OF THE COMPUTERIZED RESERVATION SYSTEM, OR C.R.S. THE IMPORTANCE OF THESE SYSTEMS IN TODAY'S AIRLINE INDUSTRY CANNOT BE OVERSTATED. THE VAST MAJORITY OF AIRLINE RESERVATIONS ARE MADE USING THE CRS SYSTEM BECAUSE THE PUBLIC BELIEVES THAT THE USE OF A TRAVEL AGENT INSTEAD OF AN INDIVIDUAL AIRLINE MAXIMIZES THEIR ABILITY TO RESERVE THE CHEAPEST FLIGHT AT THE MOST CONVENIENT TIME. PASSENGERS BELIEVE THAT A TRAVEL AGENT HAS EQUAL ACCESS TO ALL FLIGHTS BY ALL AIRLINES.

MANY OF OUR AIRLINES HAVE THEIR OWN CRS SYSTEMS, WHILE OTHERS DO NOT. THOSE THAT DO NOT OWN A CRS SYSTEM, GENERALLY HAVE ACCESS TO ALL THE OTHER AIRLINES' SYSTEM. THE SYSTEMS ARE

PRESENTLY PROVIDING LARGE PROFITS TO THE AIRLINES THAT OWN THEM.

COMPUTER RESERVATION SYSTEMS PLAY A LARGE PART IN ENSURING THE OVERALL COMPETITIVENESS OF THE AIRLINE INDUSTRY. THIS OVERALL COMPETITIVENESS, OF COURSE, WORKS TO THE BENEFIT OF THE AMERICAN CONSUMER, AND MUST BE PRESERVED.

IN 1983, THE CIVIL AERONAUTICS BOARD PASSED SEVERAL REGULATIONS DESIGNED TO CURB ABUSES OF THE CRS SYSTEM. HOWEVER, MANY TODAY FEEL THAT THESE REGULATIONS ARE INSUFFICIENT OR ARE NOT BEING ENFORCED, AND THAT REMEDIAL LEGISLATION IS NECESSARY.

THE ISSUES RAISED REGARDING THE NEED FOR LEGISLATION INCLUDE THE PROPRIETY OF THE FEES CHARGED FOR ACCESS TO COMPUTER RESERVATION SYSTEMS, THE PROPRIETY OF SOME CONTRACTUAL PROVISIONS BETWEEN AIRLINES AND TRAVEL AGENTS, AND THE FAIRNESS OF FLIGHT DISPLAYS ON C.R.S. SCREENS.

ALL OF THESE ISSUES NEED TO BE BROUGHT FORTH AND ANALYZED. THE MOST IMPORTANT CONCERN, AND CONGRESS'S UNDERLYING GOAL, MUST BE TO PROVIDE THE MAXIMUM BENEFIT POSSSIBLE TO THE AMERICAN CONSUMER. I HOPE THAT TODAYS HEARING WILL BE THE FIRST STEP TOWARD THAT GOAL.

Senator DECONCINI. I do want to thank you for calling these hearings. I think it is an important issue that we have to grapple with and it is a situation that cannot continue. It really concerns me what has happened to the deregulation philosophy of commercial airlines and there appears to be some real hand-tieing that has been permitted to go on. I appreciate Mr. Scocozza's testimony here. The transportation system is inundated as we know this time of year, so it is timely, Mr. Chairman, that you would be working in this area, and I hope that these hearings will produce meaningful legislation by which we can lay out a level playing field for all airlines and all customers of the airlines, which I do not think we have now.

Thank you, Mr. Chairman.

Senator METZENBAUM. Thank you.

Senator Thurmond, I think you have a question or two?

Senator THURMOND. Just two brief questions.

Mr. Scocozza, what is your understanding of why Delta does not include liquidated damage provisions in its contracts?

Mr. SCOCOZZA. That is a good question, one that I asked myself, and an important question that I also asked was: Is Delta losing customers. Is there a difference in the level of customers Delta has had? And the answers across the board have been no, that Delta's system is functioning because of its reputation, its marketing to its clientele, and liquidated damages do not appear to be an important part of their business program. But I would say that would be a more specific question for Delta, and I would be as interested in the answer.

Senator THURMOND. In your testimony, I believe you state that you believe that overt display bias has been effectively eliminated. Is there any other kind of bias about which we should be concerned?

Mr. SCOCOZZA. There is a pattern, Senator, where in a carrier could perhaps, by one minute or two, misrepresent its schedule for the purpose of getting better position on the screen. I can speak very clearly about a problem which makes foreign carriers very upset, arising from the fact that interlining carries with it a large display penalty, irrespective of the actual fight time. For example, British Airways may arrive in New York connecting to U.S. Air to Pittsburgh, as opposed to, an American carrier going between London and New York, continuing on to Pittsburgh. Because British Airways interlines with another carrier, that incurs a penalty which varies among CRS's and imposes a lower position on the screen.

Foreign carriers believe that that is a very serious form of discrimination against their ability to compete in the United States. It is with respect to rules of priority on the screen with potential discriminatory impact that issues arise which the study may address.

Senator THURMOND. Thank you very much. That is all, Mr. Chairman.

Senator METZENBAUM. Thank you very much, Mr. Scocozza. Your testimony is helpful, your answers are normally very direct and to the point. I would say to you that one thing I would urge is that the Department of Transportation accelerate its timetable, it takes too long to make studies, to make evaluations, and it is government ponderously moving along.

I have thrown out a suggestion to you with respect to this matter of liquidated damages versus actual damages. Probably the best way would be for actual damages, and which specific costs they include, to be determined either by an arbitrator or by the courts.

I would say to you that we are going on recess very shortly. We will be coming back in January and perhaps we can really get down to work then or in February. If the Department of Transportation has not moved promptly in this area, then this Senator will move to see if the matter can be resolved amicably. Absent that, I will move forward with the legislative package.

I would much prefer to see the Department of Transportation, which I think is far better able to handle a matter of this kind, do the job but not at your usual timetable.

Mr. SCOCOZZA. Thank you, Mr. Chairman. If I can, just one point that Senator Thurmond asked about, Delta not having liquidated damages: I am aware of a claim that SystemOne, which is the Eastern and Continental system, has not completely excluded liquidated damages. I think their representation to the Department is that their liquidated damages are extremely minimal.

So the question, Senator, that you would pose to Delta I would also pose to Continental in terms of the impact of liquidated damages.

Senator, thank you very much for having me here. I enjoyed being here this morning.

Senator METZENBAUM. Thank you very much.

Our next panel consists of Mr. A.B. Magary, Executive Vice President for Marketing, Northwest Airlines; Edward R. Beauvais, Chairman of the Board, America West Airlines, Inc., Tempe, Arizona; and Michael E. Levine, General George Rogers Clark Professor of Management, Yale University, of New Haven, Connecticut.

We will be happy to hear from each of you. Mr. Levine is also a consultant for Continental Airlines. We are happy to have all of you here with us today.

Mr. Magary, will you proceed? The time is running out on the committee's time limits, and so I am going to hold you to the 5 minutes and give you the croix de guerre if you can do it in four. Please proceed.

A PANEL CONSISTING OF A.B. MAGARY, EXECUTIVE VICE PRESIDENT FOR MARKETING, NORTHWEST AIRLINES, MINNEAPOLIS, MN; EDWARD R. BEAUVAIS, CHAIRMAN OF THE BOARD, AMERICA WEST AIRLINES, INC., TEMPE, AZ; AND MICHAEL E. LEVINE, GENERAL GEORGE ROGERS CLARK PROFESSOR OF MANAGEMENT, YALE UNIVERSITY, NEW HAVEN, CT

Mr. MAGARY. Good day, Mr. Chairman, Senators. I will try to speak quickly. My name is A.B. Magary. I am executive vice president for marketing at Northwest Airlines.

As you said, Mr. Chairman, there is a CRS problem. The computer reservation systems placed by airlines in travel agencies pose the most serious anti-competitive problem in the airline industry today.

Before the CAB expired, it attempted to correct this problem through rulemaking. Subsequent studies by both the DOJ and the GAO concluded that these rules did not correct the monopoly power of the major CRS vendors. They found, in fact, that the vendors had adopted new mechanisms to further entrench their monopoly position.

I want to focus your attention on the two most serious threats to competition posed by these systems. The first of these threats is the binding of agents. The major CRS vendor airlines have devised the contracts with agents so that the contract prevents future consideration by travel agents of any other CRS. The CAB wanted agents to have continuing freedom of choice among vendors; instead, the dominant vendors used the opportunity of the CAB's rules to rewrite contracts so that agents were more tightly bound than ever to their existing vendors.

This binding has been achieved in three ways: First, through long-term contracts. The CAB prevented any vendor agent contract from being longer than 5 years, and, as Mr. Murray described, United and American found a way around that one quickly through the advent of rollover clauses.

Second, exclusivity clauses. These prevent travel agents from using more than one system. While the CAB barred exclusivity, American and United found a way to achieve exclusivity through minimum use clauses which require a high enough proportion of agents' tickets to be written on that system so that it becomes uneconomical to install a second system for the few remaining bookings. Thus the dominant vendors have obtained exclusivity under another name.

And, third, liquidated damages. The CAB expressed concern that liquidated damages clauses would be used by vendors to make it prohibitively expensive for agents to ever switch to another vendor, but they made no rule. American and United promptly put new clauses in their contracts vastly increasing the liquidated damages any travel agent would pay in order to switch systems. These liquidated damages go far beyond future rentals and actual removal costs. They include assessments far beyond the financial reach of a small independent travel agent.

What is at stake here is not just the well being of agents, important though that might be. The dominant vendors are using the binding of agents as a device for entrenching themselves in one of the most powerful monopolies in America today.

While the first threat is the abusive binding of agents, the second threat posed by the CRS system is unrestrained and exorbitant booking fees charged to other carriers. The CAB in 1984 found that CRS vendors used their monopoly power to set fees at levels which bore no reasonable relationship to costs, and that was at a time when fees were typically 50 cents per booking.

Immediately after the CAB ruled, the vendors raised their booking fees to the $1.80 level, an increase of three to five times what the airlines were typically paying beforehand. Certainly if a 50-cent fee bore no relationship to costs, $1.80 has borne even less relationship to costs.

The Constitution gives Congress the sole power to tax. CRS monopoly power gives dominant vendor airlines the power to tax their competitors. Dominant vendor airlines can take money from their competitors and use that money to expand into competitors' markets. They can force the competitors to finance their own expansion.

This is not an academic subject to me. Before my present job, I had a similar position at Republic Airlines, one of the smaller major airlines and one of the many airlines which recently ceased to exist. Carriers like Republic, Western, Piedmont, Ozark, People Express, New York Air, Frontier, World, PSA, Air Cal, and many others no longer exist as independent companies. In all cases they have left the field in the past year and a half. Why?

Each of these airlines had the fundamental problem that it did not have and could not get a stake in a CRS system, and in a business increasingly dominated by CRS monopoly power, that meant sooner or later having no future at all.

At Republic, we had staged a turnaround and were doing fairly well——

Senator METZENBAUM. Could you please wind up?

Mr. MAGARY [continuing.] But we knew that in the long run, without the ability to get in the CRS, we had no future.

Thank you.

[The prepared statement of Mr. Magary follows:]

TESTIMONY OF

A.B. MAGARY

EXECUTIVE VICE PRESIDENT FOR MARKETING

NORTHWEST AIRLINES

MY NAME IS A.B. MAGARY AND I AM EXECUTIVE VICE PRESIDENT FOR MARKETING AT NORTHWEST AIRLINES.

THE SUBJECT YOU HAVE CHOSEN FOR THIS HEARING - THE COMPUTER RESERVATION SYSTEMS PLACED BY AIRLINES IN TRAVEL AGENCIES - IS A VERY IMPORTANT ONE. IT IS, IN FACT, THE MOST SERIOUS ANTI-COMPETITIVE PROBLEM IN THE AIRLINE INDUSTRY TODAY. THESE SYSTEMS, AS THEY ARE PRESENTLY DEPLOYED, THREATEN THE FULL AND FREE COMPETITION AMONG AIRLINES. THEY THEREFORE THREATEN THE CONSUMER'S INTEREST, THE PROTECTION OF WHICH IS NOW LEFT PRIMARILY TO COMPETITION, AND DEREGULATION ITSELF, WHICH IS VIABLE ONLY TO THE EXTENT THE AIRLINE INDUSTRY REMAINS A COMPETITIVE ONE.

WHEN CONGRESS DEREGULATED THE AIRLINE INDUSTRY IN 1978, AIRLINE-OWNED CRS'S WERE IN A FEW TRAVEL AGENCIES, BUT WERE NOT A SIGNIFICANT COMPETITIVE TOOL. NOW THEY ARE IN VIRTUALLY EVERY TRAVEL AGENCY OF ANY CONSEQUENCE, TRAVEL AGENTS WRITE MORE THAN 80% OF ALL AIRLINE TICKETS IN THIS COUNTRY, AND CRS's HAVE BECOME THE MOST POWERFUL MARKETING TOOL IN THE AIRLINE INDUSTRY. THIS TRANSFORMATION WAS NOT FORESEEN BY CONGRESS AT THE TIME DEREGULATION WAS ENACTED.

BY 1983 BOTH THE DEPARTMENT OF JUSTICE AND THE CIVIL AERONAUTICS BOARD WERE INVESTIGATING THE ANTI-COMPETITIVE EFFECTS OF THE CRS INDUSTRY ON THE AIRLINE INDUSTRY. BOTH FOUND THAT THE DOMINANT CRS VENDORS HAD MONOPOLY POWER AND POSED AN ANTI-COMPETITIVE THREAT TO THE AIRLINE INDUSTRY AND TO ITS CONSUMERS. (1)

---

(1) "The behavior of major CRS firms is not the behavior that would occur if CRS were a competitive industry."
-Department of Justice, Comments to the Civil Aeronautics Board, 1983.

"After almost two years of investigation, the Department of Justice concluded that there were serious competitive problems in the CRS industry, primarily because of the structure of the industry. ...Individual CRS's, particularly the dominant systems of United and American Airlines, had market power. Our investigation also indicated that the structure of the CRS market gave carrier-vendors, such as United and American, the incentive and ability to use their market power in the CRS market to extract supra-competitive profits, and to raise the cost of their actual and potential rivals (both other airlines and other CRS vendors). The structure of the market, in other words, enabled the larger carrier-vendor CRSs' (Sabre and Apollo) to exercise and perpetuate market power to the detriment of competition.
-Department of Justice, testimony to Congress, 1985.

"Our review of CRS vendor practices has revealed conduct producing competitive harms that may be analogous to conduct that could be labelled an abuse of monopoly power under the Sherman Act, 15 USC 2." -CAB, Notice of proposed Rulemaking, 1984.

"...CRS owners have a substantial degree of power over price and output in the CRS industry. Moreover, because they are competitors in the downstream air transportation industry, they have the ability and incentive to exercise that power in was that may interfere with air transport competition."
-CAB. Final Rule. Federal Register, August 15, 1984.

(footnote continued next page)

"Among the several types of conduct we found to be unfair methods of competition were the following:

1. Discriminatory treatment of downline competitors by a competitor with upstream market power. See LaPeyre v. FTC, 366 F2d 117 (5th Cir. 1966);

2. The use of market power in one market to induce the purchase of services in another, Hirsh v. Martindale-Hubble, Inc., 674 F.2d 1343 (9th Cir. 1982);

3. The use of market power in one market to gain an unwarranted competitive advantage in another, Berkey Photo, Inc. v. Eastman Kodak col, 360 F.2d 263 (2nd Cir.1979).

4. The exclusive use of information gained by virtue of a competitor's upstream market position from the monopoly to disadvantage downstream competitors, Second Computer Inquiry, 77 FCC 2nd 384, 480-81(1980); and

5. Inducing purchasers to accept exclusive contracts that are restrictive in character. See FTC v. Motion Picture Advertising Service Co., 344 U.S. 392 (1953).

-CAB Final Rule. Federal Register. August 15, 1984, p. 32542.

THE CAB IN 1984, THE LAST YEAR OF ITS EXISTENCE, ATTEMPTED TO CORRECT THESE ANTI-COMPETITIVE ABUSES THROUGH A LIMITED FORM OF RULEMAKING. (2) SUBSEQUENT STUDIES BY BOTH THE DEPARTMENT OF JUSTICE AND THE GENERAL ACCOUNTING OFFICE CONCLUDED THAT THE PROMULGATION OF THOSE RULES DID NOT CORRECT THE MONOPOLY POWER OF THE MAJOR CRS VENDORS. (3) THEY FOUND, IN FACT, THAT THE VENDORS HAD ADOPTED A VARIETY OF NEW MECHANISMS TO FURTHER ENTRENCH THEIR MONOPOLY POSITION.

I WANT TO FOCUS YOUR ATTENTION ON THE TWO MOST SERIOUS THREATS TO COMPETITION POSED BY THESE SYSTEMS, WHAT THE CAB ATTEMPTED TO DO ABOUT THEM IN ITS 1984 RULE, AND WHAT HAS ACTUALLY HAPPENED SINCE 1984.

---

(2) 14 CFR 255. See Federal Register, Vol. 49, No. 159, Aug 15, 1984, p. 32540 et. seq.

(3) "...The dominant CRS vendors apparently continue to possess market power. ...Entry into the CRS industry remains difficult. We conclude that de novo entry in the foreseeable future is very unlikely.... The exercise of CRS market power could harm competition in airline transportation markets."
-Department of Justice, Report to Congress, 1985.

"The implications of monopolistic abuses in the market for CRS services can be serious for competition in air travel markets.... The Department of Justice report concludes that the market for CRS services is, and will remain in the foreseeable future, highly concentrated, with United and American continuing to control about 70 percent of all domestic revenue booked by travel agents. Justice notes that there has been no new entry since 1983 and no significant change in the market shares of the six CRS vendors.... Overall, we concur in the Justice Department's analysis of market structure and conclude that both United and American (as well as, in some markets, other CRS vendors) have, and are likely to continue to possess, significant market power.
-GAO Report, Airline Competition: Imput of Computerized Reservations Systems, 1986.

THE FIRST OF THESE THREATS IS THAT THE MAJOR CRS VENDOR-AIRLINES HAVE DEVISED THEIR CONTRACTS WITH AGENTS SO THAT THE CONTRACT PREVENTS FUTURE CONSIDERATION BY TRAVEL AGENTS OF ANY OTHER CRS SYSTEM. THE CAB WANTED AGENTS TO HAVE CONTINUING FREEDOM OF CHOICE AMONG VENDORS. (4) INSTEAD THE DOMINANT VENDORS USED THE OPPORTUNITY OF THE CAB's RULES TO REWRITE CONTRACTS SO THAT AGENTS WERE MORE TIGHTLY BOUND THAN EVER TO THEIR EXISTING VENDORS.

SPECIFICALLY, THE CAB WAS CONCERNED THAT AGENTS WOULD BE TIED TO THEIR EXISTING VENDORS BY LONG-TERM CONTRACTS. THEY THEREFORE PROHIBITED ANY VENDOR-AGENT CONTRACT FROM BEING LONGER THAN 5 YEARS. (5) HOWEVER CAB ALSO EXPRESSED THE HOPE, WHICH IN RETROSPECT SEEMS VERY NAIVE, THAT THE VENDORS WOULD NORMALLY USE CONTRACTS OF MUCH SHORTER DURATION.(6)

---

(4) "...barganing power of agents should change for the better as a result of the rule.... In addition, the contract rules will enable agents to take advantage of CRS competition to achieve lower costs."
-CAB Final Fule. Federal Register, Aug 15, 1984, p. 32561.

(5) "We will intervene to eliminate only those contract terms clearly designed to prevent travel agents from switching systems. We have found no other business justification for the lengthy contracts." CAB Final Rule. Federal Register, August 15, 1984, p. 32556.

(6) "Subscribers and CRS vendors are, of course, free to negotiate contracts of shorter duration and we hope that a shorter term does become the industry standard." CAB Final Rule. Federal Register, August 15, 1984, p. 32556.

IN FACT WHAT HAPPENED WAS THAT THE 5 YEAR MAXIMUM BECAME THE STANDARD NEW CONTRACT. MORE IMPORTANTLY, CRS VENDORS PUT ROLLOVER CLAUSES INTO THE CONTRACTS. THESE CLAUSES GENERALLY START A NEW 5 YEAR CONTRACT TERM EVERY TIME THE AGENT ORDERS A NEW PIECE OF EQUIPMENT. (7) A TYPICAL AGENT WILL REQUIRE A NEW TERMINAL OR PRINTER SEVERAL TIMES DURING A NORMAL CONTRACT TERM. THE RESULT IS THAT FOR ALL PRACTICAL PURPOSES MOST TRAVEL AGENTS ARE LOCKED IN PERPETUAL CONTRACTS. THIS, OF COURSE, IS TOTALLY CONTRARY TO THE INTENT OF THE CAB IN PROMULGATING THE 1984 CRS RULES.

THE CAB ALSO SOUGHT TO PROTECT AGENTS FROM THE ANTI-COMPETITIVE EFFORTS OF CRS VENDORS BY PROHIBITING CONTRACT CLAUSES CALLED EXCLUSIVITY CLAUSES, WHICH PREVENT TRAVEL AGENTS FROM CHOOSING TO USE MORE THAN ONE CRS SYSTEM. (8)

---

(7) This past September, several CRS vendor airlines announced that they were voluntarily adopting policies of no longer enforcing the rollover clauses in their contracts. While we welcome that announcement, we also believe that rollover clauses should be specifically barred by government action so that they cannot be reinstated by the vendors at some future date.

(8) "...our prohibition on exclusivity clauses should open up the market and permit agents to have more than one system." CAB Final Rule, Federal Register, August 15, 1984, p. 32556.

IN PRACTICE, HOWEVER, VENDORS FOUND A WAY TO ACHIEVE EXCLUSIVITY WITHOUT ACTUALLY USING EXCLUSIVITY CLAUSES. THEY DID SO THROUGH MINIMUM USE CLAUSES WHICH REQUIRE A HIGH ENOUGH PROPORTION OF AN AGENT'S TICKETS TO BE WRITTEN ON THAT CRS THAT IT BECOMES UNECONOMICAL TO INSTALL ANOTHER CRS FOR THE RELATIVELY FEW REMAINING BOOKINGS. THUS THE VENDORS HAVE ACHIEVED EXCLUSIVITY UNDER ANOTHER NAME, THE CLEAR INTENT OF THE CAB HAS BEEN THWARTED AND AGENTS HAVE BEEN DEPRIVED OF ANOTHER FORM OF CHOICE AMONG CRS VENDORS.

FURTHERMORE, THE CAB EXPRESSED GREAT CONCERN THAT LIQUIDATED DAMAGES CLAUSES IN CONTRACTS WOULD BE ABUSED BY VENDORS TO MAKE IT PROHIBITIVELY EXPENSIVE FOR AGENTS EVER TO SWITCH TO ANY OTHER CRS VENDOR. (9) THE CAB DECIDED, HOWEVER, THAT IT WOULD NOT ATTEMPT TO LIMIT LIQUIDATED DAMAGES, IN LARGE PART BECAUSE THEY BELEIVED - WE NOW KNOW WRONGLY - THAT THEIR NEW PROHIBITIONS ON LONG TERM CONTRACTS AND EXCLUSIVITY CLAUSES WOULD BE SO EFFECTIVE THAT THE POTENTIAL FOR ANTI-COMPETITIVE ABUSE OF LIQUIDATED DAMAGES WOULD BE DIMINISHED. IN REALITY, THE CRS VENDORS, FOLLOWING THE PROMULGATION OF THE CAB NEW RULE, PROMPTLY PUT NEW CLAUSES INTO THEIR CONTRACTS VASTLY INCREASING THE LIQUIDATED DAMAGES ANY TRAVEL AGENT WOULD HAVE TO PAY IN ORDER TO SWITCH CRS's. AS A RESULT IT IS NOT UNUSUAL FOR IT TO COST A SWITCHING TRAVEL AGENT MORE

---

(9) "...we (are) concerned that liquidated damages clauses requiring substantial payments could inhibit entry into the CRS industry, especially when combined with lengthy contract terms." CAB Final Rule, p. 32556.

IN PAYMENTS TO HIS OR HER FORMER CRS VENDOR THAN THAT AGENCY WILL TAKE IN COMMISSION REVENUE FOR AN ENTIRE YEAR. OBVIOUSLY MOST TRAVEL AGENTS FIND THAT PROHIBITIVELY EXPENSIVE AND ARE THEREFORE SUCCESSFUL BARRED FROM EXERCISING THEIR FREE CHOICE IN WHAT SHOULD BE A COMPETITIVE MARKETPLACE.

SOME HAVE ARGUED THAT IN SOME CASES THESE CLAUSES ARE SO OUTRAGEOUSLY PUNITIVE THAT THEY WOULD NOT WITHSTAND COURT CHALLENGE. MY POINT IS THAT FEW AGENTS CAN OR WILL UNDERTAKE THE BURDEN OF A LEGAL CHALLENGE. WE HAVE TO REMEMBER THAT THE AVERAGE TRAVEL AGENCY IN THIS COUNTRY IS A SMALL BUSINESS WITH TOTAL COMMISSION REVENUES OF $100,000 TO $200,000; THE DOMINANT CRS VENDORS ARE MAJOR CORPORATIONS WITH ANNUAL REVENUES OF $7 TO 8 BILLION AND LEGAL DEPARTMENTS TO MATCH. MOST TRAVEL AGENTS ARE TRYING TO MAKE A DECENT LIVING BY CAREFULLY MANAGING A RELATIVELY SMALL BUSINESS WITH RELATIVELY SMALL MARGINS. IN MOST CASES THEY HAVE NEITHER THE RESOURCES NOR THE TEMERITY TO UNDERTAKE A BATTLE, LEGAL OR OTHERWISE, WITH THE CRS VENDOR ON WHOM THEY DEPEND FOR THE SERVICING AND SUPPORT OF THE EQUIPMENT WITH WHICH THEY EARN THEIR LIVING. MOST AGENTS THEREFORE NEVER GO TO COURT OVER THESE ISSUES AND NEVER OPENLY PROTEST. TO DO SO SOULD INVITE NOT ONLY A HOPELESSLY CRUSHING LEGAL BURDEN. IT WOULD ALSO IMPAIR THE AGENTS ABILITY TO MAINTAIN A SATISFACTORY RELATIONSHIP WITH ITS CRS VENDOR. THAT VENDOR COULD BE EXPECTED TO HARASS THE AGENCY IN A VARIETY OF WAYS TO IMPAIR ITS EFFECTIVENESS.

IN MY VIEW THIS DEGREE OF COMPETITIVE ABUSE OF TRAVEL AGENTS WOULD BY ITSELF JUSTIFY REMEDIAL ACTION BY THE FEDERAL GOVERNMENT. THERE ARE HOWEVER ADDITIONAL REASONS FOR SUCH ACTION.

THE DOMINANT CRS VENDORS HAVE TAKEN THE STEPS I HAVE DESCRIBED FOR A VERY IMPORTANT REASON, AND THAT IS TO LOCK-IN THEIR DOMINANCE OF ONE OF THE MOST HIGHLY CONCENTRATED INDUSTRIES IN AMERICA. AND THEY HAVE SUCCEEDED. THE DECEMBER 1985 STUDY BY THE DEPARTMENT OF JUSTICE AND THE GAO's REPORT TO CONGRESS THE FOLLOWING YEAR BOTH FOUND THAT CRS MARKET SHARES HAD NOT CHANGED AS A RESULT OF CAB'S RULES AND THAT THE DOMINANT CRS VENDORS HAD SUCCESSFULLY PERPETUATED THEIR MONOPOLY POWER UNDER THOSE RULES. (10)

IRONICALLY THE CAB HAD STATED WHEN IT PROMULGATED ITS RULES WITHOUT INCLUDING LIMITATIONS ON EXCESS LIQUIDATED DAMAGES THAT IT WAS CONCERNED ABOUT THE POTENTIAL ANTI-COMPETITIVE EFFECTS OF THOSE DAMAGES, THAT IT WOULD CLOSELY MONITOR PRACTICES WITH REGARD TO SUCH DAMAGES, AND THAT IT

---

(10) "Market shares of the CRS vendors...have not changed significantly since implementation of the CRS rules.... If anything, the data suggest that smaller systems have contracted under the rules." 1985 DOJ Study. pp 16 & 21.

"The Justice Department believes that it is highly unlikely that a wholly new CRS system will be developed and introduced into the CRS market. Justice cites several barriers to wholly new entry, including high costs of computer equipment and software development as well as the "liquidated damages clauses" in CRS contracts.... We agree with Justice that wholly new entry is highly unlikely because of the barriers to entry cited above.... Substantial erosion of market share is unlikely in any case because of the liquidated damages paid when a travel agent switches to a new CRS. Therefore, we do not believe that new entry, even in the unlikely event that it should occur, would have any significant effect on the captive relationship between the existing CRS owners and the airlines that need access to travel agents using the owner's systems.

-GAO Report, Airline Competition: Impact of Computerized Reservations Systems, 1986.

WOULD NOT HESITATE TO ACT IF ABUSES OCCURRED. (11) THEIR WORST FEARS HAVE BEEN CONFIRMED, NOT ONLY ON EXCESS LIQUIDATED DAMAGES BUT ALSO ON THE OTHER BINDING-OF-AGENTS ISSUES WE HAVE DISCUSSED HFRE TODAY. YET A MONTH AND A HALF AFTER THEIR RULE WENT INTO EFFECT THE CAB NO LONGER EXISTED AND ITS STATUTORY AUTHORITY AND MANDATE TO FOLLOW UP ON THESE ISSUES HAD TRANSFERRED TO THE DEPARTMENT OF TRANSPORTATION. IN JUNE 1985 DOT WAS PETITIONED BY A GROUP OF TRAVEL AGENTS (12) TO ACT ON THESE BINDING-OF-AGENTS ISSUES. THAT PETITION LANGUISHED WITHOUT ANY ACTION BEING TAKEN FOR 20 MONTHS, THEN WAS FOLDED INTO A STUDY OF CRS BOOKING FEES DOT HAD BEEN URGED TO DO BY GAO AND CONGRESS. THAT STUDY IS NOW DUE TO BE COMPLETED EARLY NEXT YEAR. IN ADDITION, THE AMERICAN SOCIETY OF TRAVEL AGENTS PETITIONED DOT IN SEPTEMBER, 1987, TO BAR MANY OF THESE CONTRACT ABUSES BY RULEMAKING. THUS FAR THERE HAS BEEN NO ACTION ON THAT PETITION.

WHAT IS AT STAKE HERE IS NOT JUST THE WELL-BEING OF TRAVEL AGENTS, IMPORTANT AS THAT IS. THE DOMINANT VENDORS ARE USING THE BINDING OF AGENTS AS A DEVICE FOR ENTRENCHING THEMSELVES IN ONE OF THE MOST

---

(11) "We are concerned...about the potential for abuse of liquidated damages clauses, and will monitor practices in this area. If abuses occur, we will consider the need to take further action." CAB Final Rule. Federal Register August 15, 1984, p. 32557.

(12) Membership of Individual Travel Agents (MITA), Petition filed June 17, 1985, Docket 43202.

POWERFUL MONOPOLIES IN AMERICA TODAY. THEY ARE PREVENTING BY ARTIFICAL AND ANTI-COMPETITIVE DEVICES THE NATURAL TENDENCY OF FREE ENTERPRISE TO CORRECT A MONOPOLY SITUATION. THE 1985 DEPARTMENT OF JUSTICE STUDY SHOWS THAT THE 2 DOMINANT CRS VENDORS HAD 74% OF THE NATIONAL CRS MARKET AND THAT THE CRS INDUSTRY WAS HIGHLY CONCENTRATED. (13) THE BINDING OF AGENTS EXISTS TO PERPETUATE THAT MONOPOLY BY ANTI-COMPETITIVE MEANS.

THE SECOND OF THE MAJOR THREATS POSED BY THE CRS SYSTEMS IS THE POWER OF THE DOMINANT CRS VENDORS TO RAISE WITHOUT COMPETITIVE RESTRAINT THE BOOKING FEES THEY CHARGE OTHER AIRLINES FOR EACH BOOKING THE AGENT MAKES ON THOSE AIRLINES.

---

(13) The Department of Justice study found in 1985 the following markets shares, expressed as a percent of agency revenue:

SABRE	(American)	46%
APOLLO	(United)	28%
SODA	(Eastern)	10%
PARS	(TWA)	10%
DATA II	(Delta)	6%
MARS PLUS		1%

Applying the HHI Index of Market Concentration, the Department of Justice generally considers markets with an HHI of less that 1000 to be unconcentrated, those with HHI's of 1000 to 1800 to be moderately concentrated, and those with an HHI of more than 1800 to be highly concentrated. The above market shares for the CRS industry produce on HHI well over 3000 making it a very highly concentrated industry. The airline industry, by contrast, has an HHI nationally of about 1200.

THE CAB IN 1984 FOUND THAT THE CRS VENDORS THEN HAD MONOPOLY POWER IN SETTING CRS BOOKING FEES TO OTHER AIRLINES AND THAT THEY USED THAT MONOPOLY POWER TO SET THOSE PRICES AT LEVELS WHICH BORE NO REASONABLE RELATIONSHIP TO COSTS. (14) THAT WAS AT A TIME WHEN THE FEES WERE TYPICALLY LESS THAT 50¢ PER BOOKING. IMMEDIATELY AFTER THE CAB'S RULE THE VENDORS RAISED THEIR BOOKING FEES TO APPROXIMATELY $1.80 PER BOOKING, AN INCREASE OF APPROXIMATELY 3 to 5 TIMES WHAT AIRLINES WERE PAYING BEFORE THE RULES. IF 50¢ BORE NO REASONABLE RELATIONSHIP TO COSTS, CLEARLY $1.80 BORE EVEN LESS.

THE CAB IN ITS RULEMAKING HAD CONSIDERED VARIOUS PROPOSALS TO LIMIT UNREASONABLE BOOKING FEES, AND HAD ITSELF PROPOSED A THIRD PARTY ARBITRATION MECHANISM TO KEEP BOOKING FEES AT REASONABLE LEVELS. INSTEAD, IT DECIDED ONLY TO PROHIBIT DISCRIMINATION IN BOOKING FEES, NOT THEIR EXCESSIVENESS, IN THE HOPES THAT THE VENDORS WOULD EITHER NOT BE INCLINED OR NOT BE ABLE TO TAKE ADVANTAGE OF THEIR MONOPOLY POSITION TO RAISE FEES. MANY COMMENTERS, INCLUDING THE DEPARTMENT OF JUSTICE, PREDICTED THAT THE RESULT WOULD BE UNIFORMLY EXCESSIVE BOOKING FEES, AND THAT IS EXACTLY WHAT HAS HAPPENED.

AGAIN, IN MAKING ITS DECISION THE CAB STATED THAT IT WAS VERY CONCERNED THAT BOOKING FEES MIGHT BE SET AT EXCESSIVE LEVELS, THAT IT WOULD CAREFULLY MONITOR THE SITUATION, AND THAT IT WOULD NOT HESITATE TO TAKE

---

(14) "The documents in Docket 41663 and the evidence gathered and catalogued in DOJ's comments show example after example in which the major vendors have...dictated fees that...were not based on costs.... (CRS vendors) virtually ignore their own costs in setting their prices..." CAB Final Rule, Federal Register, August 15, 1984, p. 32543.

ACTION ON BOOKING FEES IF THEY WERE EXCESSIVE. (15) YET, AGAIN, THE CAB WAS SOON NON-EXISTENT, AND THE DOT HAS TO DATE TAKEN NO ACTION ON BOOKING FEES. THE GAO IN ITS 1986 REPORT TO CONGRESS LARGELY REJECTED THE ACCOUNTING METHODOLOGIES THE DOMINANT CRS VENDORS HAD USED IN PUBLIC DEBATE TO DEFEND THEIR HIGH BOOKING FEES, AND THE GAO RECOMMENDED THAT DOT UNDERTAKE A STUDY OF BOOKING FEES TO DETERMINE WHETHER THEY WERE REASONABLE OR EXCESSIVE. DOT UNDERTOOK THAT STUDY IN FEBRUARY, 1987, AND NOW EXPECTS TO COMPLETE IT EARLY NEXT YEAR. IT IS INCONCEIVABLE, GIVEN PAST GOVERNMENT STUDIES ON THIS ISSUE, THAT THE DOT STUDY WILL CONCLUDE ANYTHING OTHER THAN THAT BOOKING FEES FOR THE DOMINANT CRS VENDORS BEAR NO REASONABLE RELATIONSHIP TO COSTS AND ARE EXCESSIVE DUE TO MONOPOLY POWER. THE OPEN QUESTION IS WHAT DOT WILL DECIDE TO DO ABOUT THAT PROBLEM. THE DOMINANT CRS VENDORS MAY HAVE SIGNALLED THEIR LACK OF CONCERN BY, IN THE PAST FEW MONTHS, INSTITUTING ANOTHER ROUND OF BOOKING FEE INCREASES, DESPITE THE FACT THAT DOT'S STUDY WAS PENDING ON WHETHER THEIR PREVIOUS BOOKING FEES WERE EXCESSIVE.

---

(15) "Although we have decided against the various proposals for additional pricing rules, we recognize that pricing issues are perhaps the most difficult issues confronting us. We are aware of the possibility that market power may allow vendors to charge excessive fees and of the potentially adverse consequences for air transportation competition of such fees. Our failure to take further action now should not be viewed as an irreversible conclusion that further price regulation is not in fact necessary. We expect to monitor the situation and to adopt additional pricing rules should the need arise. We would expect our succesor to do the same." CAB Final Rule, Federal Register, August 15, 1984, p. 32553.

THE SIGNIFICANCE OF EXCESSIVE BOOKING FEES IS ENORMOUS. EXCESSIVE FEES ARE HOW A PROBLEM OF MARKET DOMINANCE IN THE CRS INDUSTRY, AND THE POWER OF THE DOMINANT CRS VENDORS TO ANTI-COMPETITIVELY PERPETUATE THAT DOMINANCE BY BINDING AGENTS TO THEIR SYSTEMS, BECOMES A FORCE THAT DISTORTS AND ULTIMATELY REDUCES COMPETITION IN THE AIRLINE INDUSTRY AND THEREFORE ADVERSELY EFFECTS THE INTERESTS OF THE CONSUMERS OF AIR TRANSPORTATION. THE DOMINATE CRS VENDOR AIRLINES HAVE THE POWER, THROUGH CRS BOOKING FEES, TO EXTRACT ANY AMOUNT OF MONEY THEY WISH FROM THE AIRLINES WITH WHICH THEY COMPETE. THERE IS NO MARKETPLACE RESTRAINT ON BOOKING FEES. AS THE CAB FOUND, AIRLINES HAVE NO CHOICE BUT TO LIST THEIR FLIGHTS IN ALL THE CRS'S, NO MATTER WHAT THE BOOKING FEE MAY BE: WE CANNOT COMPETE IN THE AIRLINE BUSINESS UNLESS WE ARE IN ALL SYSTEMS. (16) VENDOR AIRLINES ARE RESTRAINED IN SETTING BOOKING FEES ONLY BY THEIR FEAR OF WAKING WASHINGTON, AND THAT FEAR HAS THUS FAR NOT BEEN VERY GREAT.

---

(16) "Because of economics of aircraft size, the time sensitivity of a substantial portion of passengers, and the geographic dispersion of potential passengers for a given flight, ignoring a substantial fraction of travel agents can have severe negative impact on the economic viability of a carriers' service. Thus, from the carrier's perspective, CRS's are in many respects not substitutes for one another. Access to SABRE agents does not render access to APOLLO agents unnecessary, and vice-versa."

-CAB, Final Rule, Federal Register,
August 15, 1984.

For these reasons, even the national market share data we cite on the CRS industry (see footnote 13 above) understate the degree of concentration. Because any CRS system with any significant number of travel agents is indespensible to each airline, each CRS's travel agents in effect constitute a separate market, of which that CRS has 100% dominance.

THE CONSTITUTION GIVES CONGRESS THE SOLE POWER TO TAX. CRS MONOPOLY POWER GIVES CERTAIN AIRLINES THE POWER TO TAX THEIR COMPETITORS. VENDOR AIRLINES CAN DIVERT THE FINANCIAL RESOURCES OF THEIR COMPETITORS TO THEIR OWN PURPOSES. THEY CAN THUS TAKE MONEY FROM THEIR COMPETITORS AND USE THAT MONEY TO EXPAND INTO THEIR COMPETITORS' MARKETS OR TO RESIST ANY EFFORT BY THEIR COMPETITORS' TO ENTER THEIR MARKETS. THEY CAN FORCE THEIR COMPETITORS TO FINANCE THEIR OWN EXPANSION. AND THEY CAN FORCE THEIR COMPETING BUT LESS DOMINANT CRS VENDORS AIRLINES TO FINANCE THEIR EFFORTS TO KEEP TRAVEL AGENTS FROM SWITCHING SYSTEMS: THE COMPETITOR VENDOR-AIRLINE IS FORCED NOT ONLY TO FINANCE ITS OWN COMPAIGN TO GET AGENTS TO SWITCH BUT ALSO ITS OPPONENT'S CAMPAIGN TO KEEP AGENTS FROM SWITCHING. THUS THE POWER OF THE DOMINANT CRS VENDORS TO SET BOOKING FEES BASED ON MONOPOLY POWER BECOMES YET ANOTHER METHOD OF BINDING AGENTS AND PRESERVING THE MONOPOLY POWER WHICH MAKES ALL THIS POSSIBLE.

THIS IS NOT AN ACADEMIC SUBJECT FOR ME. BEFORE MY PRESENT JOB I HELD THE SAME JOB AT REPUBLIC AIRLINES, ONE OF THE SMALLER MAJOR AIRLINES AND ONE OF THE MANY AIRLINES WHICH RECENTLY CEASED TO EXIST. CARRIERS LIKE REPUBLIC, WESTERN, PIEDMONT, OZARK, PEOPLE EXPRESS, NEW YORK AIR, FRONTIER, WORLD, PSA, AIR CAL, AND MANY OTHERS NO LONGER EXIST AS INDEPENDENT COMPANIES OFFERING SCHEDULED AIR TRANSPORTATION, AND MANY NO LONGER EXIST AT ALL. IN ALL CASES THEY HAVE LEFT THE FIELD IN THE PAST YEAR AND A HALF. WHY? WAS IT COINCIDENCE?

NO, IT WAS NOT. EACH OF THESE AIRLINES HAD THEIR OWN SEPARATE MIX OF PROBLEMS, AS ANY BUSINESS DOES. SOME WERE DOING BADLY AT THE END, SOME, LIKE REPUBLIC, WERE ACTUALLY DOING FAIRLY WELL. BUT EACH HAD THE FUNDAMENTAL PROBLEM THAT IT DID NOT HAVE AND COULD NOT GET A STAKE IN A CRS SYSTEM, AND IN A BUSINESS INCREASINGLY DOMINATED BY CRS MONOPOLY POWER, THAT MEANT SOONER OR LATER HAVING NO FUTURE AT ALL. AT REPUBLIC WE HAD STAGED A TURNAROUND AND WERE ACTUALLY DOING FAIRLY WELL IN CURRENT TERMS. BUT AS WE LOOKED OUT IN THE FUTURE, THE DOMINANT CRS VENDORS HAD MORE ULTIMATE CONTROL OF OUR RESOURCES THAN WE DID. AND THOSE RESOURCES TAKEN FROM US WERE IN THE PROCESS OF BEING TURNED AGAINST US. IN 1985 WE AT REPUBLIC WERE FACE TO FACE WITH THE FACT THAT AMERICAN AIRLINES WAS TAKING DELIVERY OF NEW AIRCRAFT AT AN INCREDIBLE RATE OF ONE EVERY 10 DAYS. THIS WAS COMPARED TO REPUBLIC WHICH TOOK DELIVERY ON 6 NEW AIRCRAFT DURING THE MORE THAN 2 YEARS I WAS AT REPUBLIC. AMERICAN'S AIRCRAFT PURCHASES WERE FINANCED IN LARGE PART BY THE CRS MONOPOLY RENTS IT OBTAINED FROM REPUBLIC AND OTHER AIRLINES. THE POWER OF THOSE MONOPOLY RENTS IN AMERICAN'S HANDS DROVE MORE THAN ONE AIRLINE INTO THE ARMS OF A MERGER. AND THE TREND IS WRITTEN VERY PLAINLY ON THE WALL: IN 1988 AMERICAN WILL TAKE DELIVERY ON A NEW AIRCRAFT APPROXIMATELY EVERY 5 DAYS.

THOSE WHO ARE CONCERNED ABOUT CONCENTRATION IN THE AIRLINE INDUSTRY AND ARE CONCERNED ABOUT MERGERS, MISS THE POINT ENTIRELY IF THEY ARE NOT CONCERNED ABOUT CRS MONOPOLY POWER. IF THE REPUBLIC-NORTHWEST MERGER HAD BEEN DISAPPROVED, REPUBLIC WOULD HAVE HAD TO LOOK ELSEWHERE FOR A MERGER PARTNER. IF THE MERGER OPTION HAD BEEN TOTALLY FORECLOSED TO US, WE WOULD HAVE BEEN DRIVEN INTO THE GROUND LIKE FRONTIER WAS. YOU CANNOT

SURVIVE AGAINST A COMPETITOR WHO THROUGH CRS MONOPOLY POWER HAS UNLIMITED POWER TO TAX YOU AND THEREFORE TO DIRECT YOUR RESOURCES TO HIS BENEFIT. INCREASED INDUSTRY CONCENTRATION IS THE INEVITABLE RESULT, WHETHER OR NOT ANY MERGERS ARE APPROVED.

WE ARE WELL ALONG IN A TRANSITION TO A NEW STRUCTURE IN THE AIRLINE INDUSTRY. BARRING SOME EFFECTIVE AND PROMPT ACTION BY GOVERNMENT ON THESE ISSUES, I PREDICT THAT BY THE END OF THE COMING YEAR THERE WILL BE NO AIRLINE IN THIS COUNTRY WHICH CARRIES EVEN JUST 1% OF THE PASSENGER TRAFFIC AND WHICH DOES NOT HAVE AN EQUITY POSITION IN ONE OF THE 5 CRS SYSTEMS. AND REMEMBER THAT RELATIVELY FEW AIRLINES HAVE SUFFICIENT WHEREWITHAL TO ACQUIRE THAT EQUITY POSITION IN A CRS. WE WILL THEREFORE HAVE A PASSENGER AIRLINE INDUSTRY LARGELY CONSISTING OF ABOUT 7 OR 8 CARRIERS GROUPED AROUND 5 CRS SYSTEMS. THUS THE AIRLINE INDUSTRY WILL HAVE BEEN RECAST IN THE IMAGE OF THE CRS INDUSTRY, AND THE ENTIRE PROCESS WILL HAVE HAPPENED IN A RELATIVELY BRIEF 4 YEAR PERIOD SINCE THE CAB'S CRS RULE WENT INTO EFFECT.

THIS IS PRECISELY THE "DOWNSTREAM" EFFECT OF A HIGHLY CONCENTRATED CRS INDUSTRY ON A HIGHLY COMPETITIVE AIRLINE INDUSTRY THAT THE CAB MOST FEARED AND MOST HOPED THAT ITS RULE WOULD PREVENT. (17) THEIR FEARS HAVE PROVEN PROPHETIC, THEIR HOPES UNFOUNDED.

---

(17) "...CRS owners have a substantial degree of power over price and output in the CRS industry. Moreover, because they are competitors in the downstream air transportation industry, they have the ability and incentive to exercise that power in ways that may interfere with air transport competition."

"The evidence we have unambiguously demonstrates that vendor pricing decisions are in actuality based upon the goal of manipulating downstream air transportation competition."
-CAB, Final Rule, Federal Register, August 15, 1984

FINALLY, MR CHAIRMAN, I WANT TO ADDRESS AN ARGUMENT WHICH HAS BEEN MADE BY AT LEAST ONE IF NOT BOTH OF THE DOMINANT CRS VENDORS, AND THAT IS ESSENTIALLY THAT THEY HAVE ATTAINED THEIR DOMINANT POSITION BY THEIR OWN INITIATIVE, THEY BUILT A BETTER MOUSETRAP, SO TO SPEAK, THEY DESERVE ALL THE REWARDS OF HAVING DONE SO, WHATEVER THOSE REWARDS MAY BE AND AT WHOEVER'S EXPENSE, AND GOVERNMENT SHOULD TAKE NO ACTION WHICH DEPRIVES THEM OF ANY OF THOSE REWARDS.

I AGREE THAT THEY TOOK THE INITIATIVE, BUILT WHAT WAS AT THE TIME A BETTER MOUSETRAP, AND HAVE REAPED ENORMOUS REWARDS FOR HAVING DONE SO. I ALSO BELIEVE THAT NORMALLY ONE IS ENTITLED IN THIS COUNTRY TO THE REWARDS OF TAKING THE INITIATIVE AND BUILDING A BETTER MOUSETRAP. BUT I DO NOT AGREE THAT THEY ARE ENTITLED IN THIS CASE TO THE PERPETUAL AND UNLIMITED ENJOYMENT OF THOSE REWARDS, FOR THE FOLLOWING 3 REASONS:

FIRST, IT WAS NOT ENTIRELY THEIR INNOVATIVENESS, FORESIGHT, AND CLEVERNESS WHICH PUT THEM IN THE POSITION TO CREATE CRS SYSTEMS FIRST AND TO SIGN UP MOST OF THE TRAVEL AGENTS. THE FACT IS THAT IN THE MID-1970's THE AIRLINES AND TRAVEL AGENTS WERE ENGAGED IN A JOINT PROJECT TO CREATE A NEUTRAL CRS. BUT 2 AIRLINES, UNITED AND AMERICAN, CHOSE IN THE MIDST OF THAT COOPERATIVE EFFORT TO ESTABLISH THEIR OWN SEPARATE SYSTEMS INSTEAD. IT WAS FEASIBLE FOR THEM TO DO THAT ONLY BECAUSE THE GOVERNMENT DURING THAT REGULATED ERA HAD CHOSEN TO GIVE THEM THE NATIONWIDE ROUTE SYSTEMS NECESSARY TO PURSUE THAT STRATEGY. THEIR PRESENT CRS DOMINANCE IS THEREFORE AS MUCH THE GIFT OF THE GOVERNMENT REGULATOR AS IT IS THE PRODUCT OF THEIR OWN INITIATIVE AND FORESIGHT.

SECOND, THE REWARD THEY ENJOY IS NOT SIMPLY DOMINANCE IN THE CRS INDUSTRY. THEY ARE USING THAT DOMINANCE IN THE CRS INDUSTRY TO CREATE "DOWNSTREAM" ADVANTAGES FOR THEMSELVES IN THE AIRLINE INDUSTRY, AND IN THE PROCESS ARE DAMAGING THE INTERESTS OF OTHER AIRLINE COMPETITORS, TRAVEL AGENTS, AND ULTIMATELY CONSUMERS THEMSELVES BY THREATENING COMPETITION IN THE AIRLINE INDUSTRY. IT IS THAT DOWNSTREAM EFFECT, USING MONOPOLY POWER (NO MATTER HOW OBTAINED) IN ONE MARKET TO INJURE COMPETITION IN ANOTHER, WHICH IS CONTRARY TO LONG-HELD ANTI-TRUST LAW AND POLICY IN THIS COUNTRY. FURTHERMORE, THE FEDERAL AVIATION ACT EXPRESSLY PROHIBITS UNFAIR METHODS OF COMPETITION IN AIR TRANSPORTATION. (18) THUS THE REWARDS THEY ARE OBTAINING ARE CONTRARY TO FEDERAL LAW AND POLICY AND TO THE PUBLIC INTEREST.

AND THIRD, UNDER ANTI-TRUST LAW AND POLICY IN THIS COUNTRY NO ONE IS PERMITTED TO DEFEND A MONOPOLY POWER POSITION, (NO MATTER HOW OBTAINED), BY ANTI-COMPETITIVE MEANS, SUCH AS THE VARIOUS FORMS OF BINDING AGENTS WE HAVE DISCUSSED HERE TODAY. THE CAB SOUGHT TO USE ITS POWERS UNDER THE FEDERAL AVIATION ACT TO PREVENT THAT BINDING OF AGENTS FROM HAPPENING. THE CAB's EFFORTS MUST NOW BE FOLLOWED BY THE MORE EFFECTIVE EFFORTS OF OTHERS IN THE FEDERAL ESTABLISMENT.

---

(18) Sec. 411, Federal Aviation Act.

MR. CHAIRMAN THE CRS ISSUE ULTIMATELY POSES THE QUESTION: WHAT KIND OF AN AIRLINE SYSTEM DO WE WANT IN THIS COUNTRY? I HAVE LAID OUT WHERE GOVERNMENT INACTION ON CRS IS TAKING THE AIRLINE INDUSTRY, TRAVEL AGENTS AND CONSUMERS. THE GOVERNMENT WILL HAVE TO DECIDE WHETHER IT WANTS TO CREATE THE POSSIBILITY OF A DIFFERENT FUTURE. IF IT DOES, IT IS GOING TO HAVE TO STEP TO UP THE ISSUES OF THE BINDING OF AGENTS AND OF EXCESSIVE CRS BOOKING FEES, AND THERE IS NOT A GREAT DEAL OF TIME LEFT TO DO IT.

THANK YOU VERY MUCH, AND I WOULD BE PLEASED TO TRY TO ANSWER ANY QUESTIONS YOU MAY HAVE.

Senator METZENBAUM. Thank you very much, Mr. Magary.

Mr. Beauvais.

Mr. BEAUVAIS. Thank you, Senator.

Your preliminary comments I find quite reassuring, and we certainly agree with you on the concerns that you have expressed. Since deregulation, we have seen the establishment of extensive hub and spoke connecting systems, complex and rapidly changing schedules and fare structures, and yield management programs.

As a consequence, consumers have been driven to use travel agents and the computer reservation system that these agents utilize. Indeed, approximately 75 percent of all transportation provided in the United States is now sold to travel agents. While such systems could have been provided by non-airline vendors, the reality is that carrier-owned systems dominate the marketplace today, with United's APOLLO and American's SABRE system controlling approximately 70 percent of the CRS market.

And while the CAB addressed certain of the competitive and consumer issues raised by the practices employed by the carrier owners in regulations issued during 1984, several serious problems remain, including booking practices, booking fees, commission overrides, and other incentive programs, access to the marketing data and the effects of these systems on competition within the industry, each of which is discussed in detail in my written testimony.

The impact of this development stifles the competitive balance in the airline industry. It has forced the massive consolidations that have taken place in this industry and has caused major distortions in market share when carrier owners compete with non-owner carriers. While certain of these practices can and should be remedied by further regulation, the simple fact of the matter is that the economic rewards flowing from being able to bias these systems are great, and the ability of the non-vendor carriers and the government to monitor and address abuses on anything close to a real time basis is limited. Moreover, there are several inherent advantages enjoyed by airline owners of CRS's that cannot effectively be regulated. Under these circumstances, we believe that the Congress must seriously evaluate the possibility of requiring that the ownership and control of the computer reservation systems be taken out of the hands of the carrier owners.

We do not say this lightly, because we recognize the consequences of taking such an action. But the lesson of the past 3 years since the CRS regulations have been in place is that the carrier owners are constantly devising new programs and parameters that, while technically meeting the requirements of the DOT rules, give the carrier owner a distinct advantage over its competitors. Only by proceeding in this manner can we be sure that biases will be reduced to the greatest extent possible.

Moreover, permitting the carrier owners to sell their systems will insure that they are properly compensated for their prior investment. The recent sale of CONRAIL through a public offering demonstrates that valuable assets can and in fact be marketed successfully through that mechanism.

Thank you very much.

[The prepared statement of Mr. Beauvais follows:]

TESTIMONY OF
EDWARD R. BEAUVAIS
CHAIRMAN OF THE BOARD
AND CHIEF EXECUTIVE OFFICER
AMERICA WEST AIRLINES, INC.
BEFORE THE
ANTITRUST, MONOPOLIES AND BUSINESS RIGHTS SUBCOMMITTEE
OF THE JUDICIARY COMMITTEE
UNITED STATES SENATE
DECEMBER 10, 1987

Mr. Chairman and Members of the Subcommittee, I am Edward R. Beauvais, Chairman of the Board and Chief Executive Officer of America West Airlines, Inc., a post-deregulation airline that began operations a little over four years ago. The Committee is to be commended for conducting these important hearings, and we appreciate the opportunity to appear before you today to discuss the effects of computer reservation systems both on consumers and on airline competition in general as well as the need for legislative and regulatory action with respect to these systems.

Background of America West Airlines, Inc.

By way of background, America West is one of the few remaining post-deregulation carriers. We began operations as a new entrant airline in August 1983 with three Boeing 737-200 aircraft operating to and from our Phoenix hub and the cities of Los Angeles, Kansas City, Colorado Springs and Wichita.

Since that time, we have grown dramatically, now serving a total of 45 cities in the Midwest, Southwest, Northwest, Canada, California, and in the East from our Phoenix and Las Vegas hubs. We operate a total of 60 Boeing 737, 7 Boeing 757, and 3 de Havilland Dash 8 aircraft, and, in 1987, we will carry over 10 million passengers. We now have a total of over 6,000 employees, almost all of whom own stock in our company and participate in our employee profit-sharing plan. Insofar as the future is concerned, America West will take delivery of a total of 15 new Boeing 737-300 aircraft in 1988 and 1989, as well as 3 additional Boeing 757 aircraft. By 1988, America West expects to have the most modern fleet in the industry.

As you can see, we have come a very long way in a relatively short time. We are healthy and competitive and seek to grow -- not by acquisition, but by offering better service and lower fares than our competitors. And, this brings me, of course, to the subject of today's hearing, the effects of computer reservation systems on airline competition and consumers, and the particular effects of these systems on carriers such as America West.

The Emergence Of Computer Reservation Systems In The Deregulated Airline Environment

Prior to airline deregulation, it was a relatively simple matter for a consumer to determine the service levels and fares that were available in a given airline market by consulting the *Official Airline Guide*. Several developments, however, have occurred since deregulation, including the establishment of extensive hub and spoke connecting systems, complex and rapidly-changing schedules and fare structures and yield management programs. These developments forced consumers to use travel agents and the computer reservation systems that these agents utilize. Indeed, approximately 75% of all air transportation provided in the United States is now sold through travel agents.

While such systems could have been provided by non-airline vendors, the reality is that carrier-owned systems dominate the marketplace today: indeed, the Apollo and SABRE systems, operated by United Airlines, Inc. and American Airlines, Inc., respectively, control approximately 70% of the CRS market. This situation evolved for essentially two reasons. First, the carriers realized that they could earn incremental revenues by biasing the schedule and fare information contained in their systems to favor their own services. Equally importantly, the carriers induced travel agents to book passengers disproportionately on the carrier-owner, notwithstanding the existence of better service or lower fares on other carriers, by offering travel agents biased computer reservation services at relatively little cost and by employing commission override and other incentive programs that further prevent competitive forces from working.

As the airline markets became even more complex, the (anti-competitive) value of these systems to the carrier-owners became even greater for two related reasons. The bookings made by the travel agents in these systems provided "real time" or contemporaneous information about competitors' bookings, and the greater the number of agents using a particular system, the more information was, in turn, available to the carrier-owner. Moreover, these systems permitted the carrier-owner to monitor the impact of commission override programs, thus permitting the carrier to evaluate almost instantaneously the relative success of its travel agent incentive programs as well.

While the Civil Aeronautics Board addressed certain of the competitive and consumer issues raised by the practices employed by the carrier-owners in regulations issued during 1984, several serious problems remain, including booking practices, booking fees, commission override and other incentive programs, access to marketing data, and the effects of these systems on competition within the industry.

Booking Practices

Perhaps the most insidious feature of computer reservation systems is their presentation biases, notwithstanding appearances of neutrality and the Department of Transportation's anti-bias regulations. America West has not had an opportunity, in the relatively short period of time since this hearing was announced, to conduct an exhaustive analysis of the biases remaining in each of the five carrier-owned systems that are presently in use. We have, however, developed several examples (set forth in the appendix) to demonstrate that these systems currently fail to provide airline consumers with accurate information concerning the services that are offered in the marketplace.

Without dwelling on the details of these examples, it may be seen that America West flights have, in certain instances, been completely eliminated by the operation of these systems' computer programs, thus depriving consumers of any opportunity even to be aware of these America West flights. Alternatively, America West's flights have been listed in an inferior fashion, far below flights that are not as attractive from the standpoint of total trip time. Since a substantial portion of bookings made on computer reservation systems are made from the first listings on a computer screen, the relegation of America West's flights to lower (or inferior portions of) screens means that consumers are, once again, inadequately made aware of the more attractive America West flights.

In short, notwithstanding the existence of the D.O.T. anti-bias regulations, the carrier-owner systems continue to eliminate or distort America West flights (as well as, of course, the flights of other carriers) in a competitively disadvantageous manner, and, in so doing, deprive the consumer of information concerning available flights that are more desirable than those that are, in fact, displayed in the system. And, given the obvious economic incentives on the part of carrier-owners to distort the displays in their favor, it is virtually impossible, from a practical standpoint, to attempt to regulate these practices in any meaningful manner. The only real solution is to insist that carriers not be permitted to own systems, thus eliminating the incentives to bias competitors' flight presentations.

Booking Fees

Fees paid by carriers for access to CRS systems can and do further distort the market, and prevent competition from occurring. However, at the time the C.A.B. adopted its CRS regulations in November 1984, it did not adopt either the "reasonable fee" or the "zero fee" proposals advocated in the proceeding, but did acknowledge that measures going beyond its anti-discrimination regulation might be necessary in the future:

> We are aware of the possibility that market power may allow vendors to charge excessive fees and of the potential adverse consequences for air transportation competition of such fees. Our failure to take further action now should not be viewed as an irreversible conclusion that further price regulation is not in fact necessary. We expect to monitor the situation and to adopt additional pricing rules should the need arise.

49 Fed. Reg. at 32,553.

The actions taken by the carrier-owners since adoption of these rules clearly demonstrate that the existing rules are inadequate. Initially, according to a report prepared by the General Accounting Office, the booking fees established in late 1984 by both United and American reflected "overall increases, by as much as 264 percent and 50 percent [of booking fees] for Apollo and SABRE." Airline Competition: Impact of Computerized Reservation Systems, G.A.O. Report No. RCED-86-74 (May 1986) at 11.

More recently, United and American have each increased their booking fees, and, indeed, have now adopted identical CRS fee structures. Since late 1984, American had been charging booking fees of $1.75 and $2.00 per segment, respectively, for multi-access and direct access booking, while United charged a flat fee of $1.85 per segment for multi-access and direct access bookings. About a month ago, United announced that it was increasing its booking fee $.25 to $2.10 for direct access bookings to match American's $.25 surcharge for direct access bookings. Shortly thereafter, American announced a $.10 per booking increase, to $1.85 and $2.10 respectively -- not surprisingly, the same level as United.[1/]

These booking fees lower airline competition in at least two ways. First and perhaps most importantly, the booking fees charged non-vendor carriers have become a significant cost of doing business, a cost substantially in excess of the expense incurred by these systems. In the case of America West, it will pay approximately $15 million dollars this year in booking fees to the various computer reservation systems, and the $1.85 booking charge is 3.4% of the average price for a ticket on America West. Thus, these fees have a significant cost impact on a carrier such as America West, and impair its ability to offer low fare service to the traveling public -- a disability not visited on the giant megacarriers that own (and disabuse) CRS systems.

Second, the carrier-owners do not pay booking fees on travel booked on their system, and, at the same time, receive substantial revenues from the non-vendor carriers that are required to pay the booking fees. This, in turn, permits the carrier-owners to use these additional revenues, for example, to enhance the attractiveness of their travel

---

[1/] American recently amended its fee schedule to eliminate previously-granted credits for cancellations by participants, and has included, in its participation agreements, a provision to include an as yet unspecified charge whenever a SABRE automated travel agent validates a credit card through the SABRE system.

agent commission override program: in effect, using the revenue provided by the non-vendor carriers to compete against these very carriers.

While D.O.T. has instituted a study to consider, among other things, the computer reservation system booking fees charged by the carrier-owners (Order 87-2-1), the study has yet to be completed. It is not at all clear what action, if any, D.O.T. would take should it determine that the fees charged by the carrier-owners are excessive. Furthermore, so long as the carrier-owners do not pay booking fees to themselves, they will retain an important competitive advantage unless and until the ownership of the system is divorced from the airlines.

Incentive Programs

As discussed briefly above, the anti-competitive effects of the operation of the computer reservation systems are exacerbated by the travel agent commission override programs. With the advent of deregulation and the proliferation of fare and service opportunities, travel agents became more, not less, important to consumers in their efforts to obtain information concerning service and fare alternatives. And, to the extent that travel agents were able to "steer" the business to the carrier-owners, the incremental revenue so produced was available for "sharing" with the agents. From this situation emerged the commission override programs tied into the carrier-owners that are so prevalent today.

The adverse consumer and competitive effects of such practices are as obvious as they are perverse. The simple fact of the matter is that consumers are, for the most part, totally unaware as to whether a given travel agent is receiving an override commission from a particular carrier and are similarly unaware of which computer system the agent is using. Thus, while a consumer presumably believes that a travel agent is working in the consumer's best interest, he simply does not have the necessary information upon which to evaluate whether that is the case or at least to be aware that it might not be the case. In short, the agent's interest is to obtain higher commission revenue, which means that the consumer may unknowingly be booked on more expensive or less convenient flights for which the agent receives greater rewards. The impact of these programs is, therefore, to encourage agents to act in their own interest rather than in the interest of the passenger-customer.

From a competitive standpoint, the ability of carrier-owners to use incremental revenues and the differential between the booking fees charged and the actual cost of providing the service to, in effect, subsidize its travel agent program gives these carriers an obvious advantage vis-a-vis non-vendor carriers that do not have access to either source of revenue.

Access to Marketing Data

Although the Department of Transportation regulations specify that carrier-owners must provide marketing, booking and sales data to all U.S. participating carriers on non-discriminatory terms, the implementation of that provision by the carrier-owners gives them an unfair advantage in several respects. First, the carrier-owners have access to this information effectively on an instantaneous basis, whereas other carriers receive it on a tape only once a month. Thus, carrier-owners have a tremendous competitive advantage because they can react to the information immediately, whereas non-owner carriers have a substantial wait. Second, the cost of the data is substantial, with SABRE charging $12,000.00 per month and Apollo charging $10,000.00 per month for a raw data tape -- an amount which is prohibitive to a small carrier such as America West that must purchase the data from all carrier-owners and develop programs to process the data provided by each carrier-owner.

Computer Reservations Systems And Airline Market Competition

The effects of computer reservation systems upon airline market competition occur principally in the national airline market and in particular cities. Turning initially to the national market, Northwest announced, while it was in the process of acquiring Republic, that it was purchasing an interest in TWA's computer reservation system. Similarly, Texas Air has candidly admitted that one of the reasons that it purchased Eastern Air Lines, Inc. was to gain access to its computer reservation system. Additionally, USAir argued, in the USAir-Piedmont Acquisition Case, that its acquisition of Piedmont was necessary in order to enhance USAir's ability to negotiate for an ownership interest in a computer reservation system. Presently, the computer reservation systems are in the hands of the largest carriers: American (SABRE), United (Apollo), Texas Air (System One), TWA/Northwest (PARS), and Delta (Datas II).

And, while the effect of the consolidation of the last two years is quite pronounced at the national level, the real effect of computer reservation system dominance is felt at the city level, particularly where a carrier has a significant market share. In this regard, Dr. Julius Maldutis of Salomon Brothers has recently analyzed the concentration levels at the 50 largest airports in the United States in a study entitled "Airline Competition At The 50 Largest U.S. Airports Since Deregulation" (August 1987). In this study, Dr. Maldutis concluded that, of those 50 airports (which account for 81.1% of the total scheduled passenger enplanements in the United States), 40 have "excessive amounts of concentration." And, at the ten most concentrated airports, one carrier at each has more than a 66% passenger enplanement share. The effect of the computer reservations systems and travel agent commission overrides is, of course, to reinforce these concentration levels because these competitive actions, coupled with the effects of frequent flyer programs, act as barriers to entry, thus making it extremely difficult economically for other carriers to enter these cities successfully for the purpose of providing a competitive alternative.

Remedies

Certain of the practices that we have discussed can be remedied by further regulation, including, for example, the booking fees that are the subject of D.O.T.'s ongoing investigation. However, the simple fact is that the economic rewards that flow from being able to bias these systems are great, and the ability of the non-vendor carriers and the government to monitor and address abuses on anything close to a real-time basis is limited. In addition, as Mr. James Harding discussed in a study presented during the course of hearings conducted by the Senate Aviation Subcommittee in March 1985, there are several inherent competitive advantages enjoyed by an airline owner of a CRS that cannot be dealt with effectively by regulation, including the control of development and operations of these systems as well as the physical integration of that airline's own reservation system with that serving the travel agent subscribers.

Under these circumstances, we believe the Congress must seriously evaluate the possibility of requiring that the ownership and control of the computer reservation systems be taken out of the hands of the carrier-owners. We do not say this lightly because we recognize the consequences of taking such an action. But the lesson of the past three years since the CRS regulations have been in place is that the carrier-owners are constantly devising new programs and parameters that, while technically meeting the requirements of the D.O.T. rules, give the carrier-owner a distinct advantage over its competitors.

Only by proceeding in this manner can we be sure that biases will be reduced to the greatest extent possible. Moreover, permitting the carrier-owners to sell their current systems will insure they are properly compensated for their prior investment and developmental efforts. The recent sale of Conrail by means of a public offering demonstrates that valuable assets can, in fact, be marketed successfully.

* * *

Mr. Chairman, that concludes my prepared testimony, and I would be pleased to respond to any questions that you or the other members of the Subcommittee may have.

Appendix - Examples of Display Bias Remaining In The Apollo and SABRE Computer Reservation Systems

The following examples demonstrate the manner in which the Apollo and SABRE computer reservation systems deprive airline consumers of accurate information concerning America West flights:

1. Seattle-Burbank (Apollo)

In the following example, an availability schedule was requested from Apollo for a Seattle-Burbank flight leaving at 1:00 p.m. Apollo displayed several longer flights leaving before 1:00 p.m., favoring the San Francisco hub before it displayed the faster America West connection through Las Vegas. The America West flight leaves at 1:00 p.m., and arrives at 4:50 p.m.

```
WE 16DEC   F F
1 6AS 117 F4  Y4  B4  04  M4                   SEABUR  255P  520P M80 S-S-   0
2  PS1926 Y4  B4  04  M4  V4                   SEABUR  120P  444P M80 L-L-   1
3 6AS 716 F4  Y4  B4  04  M4                   SEABUR  300P  625P M80 SSSS   1
4  AS 176 F4  Y4  B4  04  M4                   SEABUR 1110A  325P M80 -L-L   2
5  AS 116 F4  Y4  B4  04  M4                   SEABUR  535P  850P M80 -D-D   1
6  DL1734 F4  Y6  B5  H4  04  M4  K4  L4 SEASLC 1115A  158P 73S S-S-   0
7  DL1533 F4  Y6  B5  H4  04  M4  K4  L4    BUR  300P  338P 733 ----   0
```

```
WE 16DEC   F F
1 6AS2623 Y4  B4  Q4  M0                       SEAPDX 1100A 1143A DH8 ---- *0
2  AS 176 F4  Y4  B4  04  M4                      BUR 1220P  325P M80 L-L-   1
3:8AA2024 Y4  B4  H4  04  M4  V4               SEASJC 1124A  122P 73S L-L-   0
4:6AA5243 Y4  B4  H4  Q4  M4  V4                  BUR  310P  425P CVR ---- *0
5  HP1282 Y4  00  M0  K4  V0                   SEAPHX 1100A  245P 73S S-S-   0
6  HP   6 Y4  Q4  M4  K4  V4                      BUR  410P  420P 733 ----   0
7  AS 176 F4  Y4  B4  Q4  M4                   SEAOAK 1110A  155P M80 -L-L   1
8 6AS 716 F4  Y4  B4  Q4  M4                      BUR  520P  625P M80 S-S-   0
```

```
WE 16DEC   F F
1   PS1784 Y4 B4 04 M4 V0          SEASFO 1130A  219P M80 ----   1
2   PS1940 Y4 B4 04 M4 V4             BUR  247P  353P M80 ----   0
3:  NW1784 Y4 B4 04 M4 V4          SEASFO 1130A  219P M80 ---- *1
4:  NW1926 Y4 B4 04 M4 V4             BUR  340P  444P M80 ---- *0
5   PS1784 Y4 B4 04 M4 V0          SEASFO 1130A  219P M80 ----   1
6   PS1926 Y4 B4 04 M4 V4             BUR  340P  444P M80 ----   0
7   AS  84 F4 Y4 B4 04 M4          SEASFO 1155A  245P 72S -L-L   1
8   AS 752 F4 Y4 B4 04 M4             BUR  455P  605P M80 S-S-   0
```

```
WE 16DEC   F P
1   PS1784 Y4 B4 04 M4 V0          SEASFO 1130A  219P M80 ----   1
2  6PS1852 Y4 B4 04 M4 V4             BUR  435P  539P M80 ----   0
3   AS 109 F4 Y4 B4 04 M4          SEASJC 1230P  315P 72S -S-S   1
4   AS 754 F4 Y4 B4 04 M4             BUR  640P  750P M80 S-S-   0
5:  NW1784 Y4 B4 04 M4 V4          SEASFO 1130A  219P M80 ---- *1
6:  NW1754 Y4 B4 04 M0 V4             BUR  535P  641P 146 ---- *0
7   PS1784 Y4 B4 04 M4 V0          SEASFO 1130A  219P M80 ----   1
8   PS1754 Y4 B4 04 M0 V0             BUR  535P  641P 146 ----   0
```

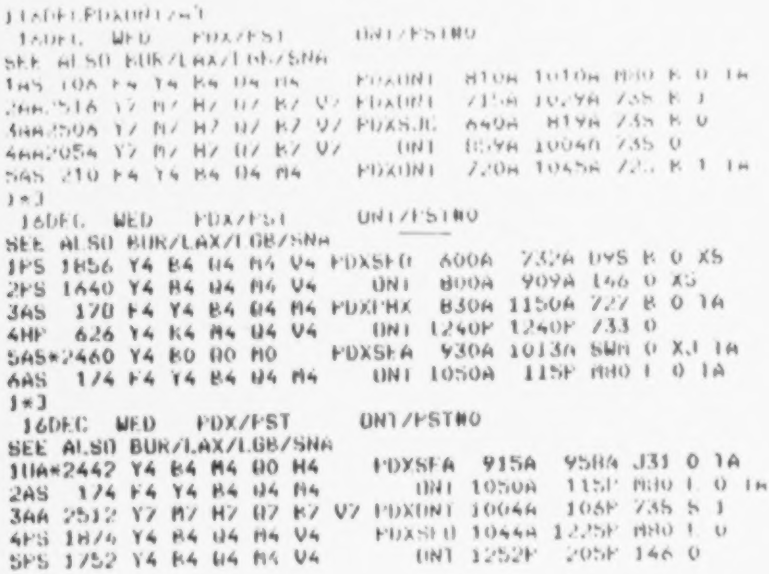
```
WE 16DEC   F P
1   HP 629 Y4 00 M0 K4 V0          SEALAS  100P  305P 73S S-S-   0
2   HP 475 Y4 04 M4 K4 V4             BUR  400P  450P 733 ----   0
3   PS1926 Y4 B4 04 M4 V4          SEASFO  120P  310P M80 L-L-   0
4  6PS1852 Y4 B4 04 M4 V4             BUR  435P  539P M80 ----   0
5   AS 192 F4 Y4 B4 04 M4          SEASFO  120P  310P 72S S-S-   0
6   AS 752 F4 Y4 B4 04 M4             BUR  455P  605P M80 S-S-   0
7   PS1926 Y4 B4 04 M4 V4          SEASFO  120P  310P M80 L-L-   0
8   PS1754 Y4 B4 04 M0 V0             BUR  535P  641P 146 ----   0
```

2. Portland-Ontario (SABRE, Apollo)

The example set forth below was taken from SABRE on December 3, 1987. It shows how America West's service is edited out because of SABRE's overlapping edit parameter. The availability schedule was requested for 7:00 a.m. from Portland to Ontario. The America West flight leaves at 7:00 a.m., making a connection in Las Vegas, arriving at 10:50 a.m. The America West service is edited out by an Alaska non-stop flight leaving at 8:00 a.m., arriving at 10:10 a.m., i.e., the America West service will never show as long as it leaves before a flight, and arrives after a flight, as well as being 31 minutes and 20% longer than any other service. This does not allow the SABRE user the option to sell the America West service because SABRE's overlapping edit parameter will not allow it to be displayed.

Using Apollo, an availability schedule was requested for Portland to Ontario at 7:00 a.m. Apollo sequenced a longer United flight leaving at 6:30 a.m., arriving Ontario at 10:45 a.m., as well as other slower flights, before the America West service that leaves at 7:00 a.m., arriving at 10:50 a.m. This helped push the America West flight to the fourth screen, even though it was faster and closer to departure time.

SABRE



```
116DECPDXONT7A
 16DEC  WED    PDX/PST        ONT/PST#0
SEE ALSO BUR/LAX/LGB/SNA
1AS 108 F4 Y4 B4 Q4 M4      PDXONT  810A 1010A M80 B 0 1A
2AA2516 Y7 M7 H7 Q7 B7 V7 PDXONT  715A 1029A 735 B 1
3AA2508 Y7 M7 H7 Q7 B7 V7 PDXSJC  640A  819A 735 B 0
4AA2054 Y7 M7 H7 Q7 B7 V7    ONT  859A 1004A 735 0
5AS 210 F4 Y4 B4 Q4 M4      PDXONT  720A 1045A 72S B 1 1A
1*1
 16DEC  WED    PDX/PST        ONT/PST#0
SEE ALSO BUR/LAX/LGB/SNA
1PS 1856 Y4 B4 Q4 M4 V4 PDXSFO  600A  732A DYS B 0 XS
2PS 1640 Y4 B4 Q4 M4 V4    ONT  800A  909A 146 0 XS
3AS  170 F4 Y4 B4 Q4 M4 PDXPHX  830A 1150A 727 B 0 1A
4HP  626 Y4 K4 M4 Q4 V4    ONT 1240P 1240P 733 0
5AS*2460 Y4 B0 Q0 M0    PDXSEA  930A 1013A SWM 0 XJ 1A
6AS  174 F4 Y4 B4 Q4 M4    ONT 1050A  115P M80 L 0 1A
1*1
 16DEC  WED    PDX/PST        ONT/PST#0
SEE ALSO BUR/LAX/LGB/SNA
1UA*2442 Y4 B4 M4 Q0 H4     PDXSEA  915A  958A J31 0 1A
2AS  174 F4 Y4 B4 Q4 M4        ONT 1050A  115P M80 L 0 1A
3AA 2512 Y7 M7 H7 Q7 B7 V7 PDXONT 1004A  106P 735 S 1
4PS 1874 Y4 B4 Q4 M4 V4     PDXSFO 1044A 1225P M80 L 0
5PS 1752 Y4 B4 Q4 M4 V4        ONT 1252P  205P 146 0
```

SABRE (Cont'd.)

```
 16DEC  WED   FDX/FST      ONT/FST#0
SEE ALSO BUR/LAX/LGB/SNA
1AA 2528 Y7 M7 H7 Q7 B7 V7    FDXSFO 1100A 1255P 735 S 0
2AA 2752 Y7 M7 H7 Q7 B7 V7       ONT  239P  352P 735 0
3HP   28 Y4 K4 M4 Q4 V4       FDXPHX 1100A  215P 735 S 0
4HP  630 Y4 K4 M4 Q4 V0          ONT  335P  335P 735 0
5DL 1442 F4 Y4 B4 M4 Q4 H4 K4 FDXLAX 1220P  223P 72S L 0 TA
   -     L4
6DL*5396 Y4 B4 M4 Q0 H0 K0 L0    ONT  302P  327P SWM 0 XJS TA
1*J
 16DEC  WED   FDX/FST      ONT/FST#0
SEE ALSO BUR/LAX/LGB/SNA
1AS   84 F4 Y4 B4 Q4 M4 FDXONT  105P  425P 72S L 1 TA
2AS  176 F4 Y4 B4 Q4 M4 FDXONT 1220P  415P M80 L 2 TA
3AS   84 F4 Y4 B4 Q4 M4 FDXSFO  105P  245P 72S L 0 TA
4PS 1846 Y4 B4 Q4 M4 V0    ONT  415P  528P 146 0
5NW*1822 Y4 B4 Q4 M4 V4 FDXSFO  155P  330P D9S L 0 TA
NO LCL TRFC
6NW*1846 Y4 B4 Q4 M4 V0    ONT  415P  528P 146 0 TA
NO LCL TRFC
1*J
 16DEC  WED   FDX/FST      ONT/FST#0
SEE ALSO BUR/LAX/LGB/SNA
1PS1822 Y4 B4 Q4 M4 V4    FDXSFO  155P  330P D9S L 0
2PS1846 Y4 B4 Q4 M4 V0       ONT  415P  528P 146 0
3AS 189 F4 Y4 B4 Q4 M4    FDXSJC  140P  315P 72S S 0 TA
4AA2560 Y7 Q7 H7 M7 V7 B7    ONT  400P  508P 735 0
5JK 317 Y4 B4 Q0 K4 V4    FDXRNO  [illegible]  [illegible] D9S 0
6JK 304 Y4 B4 Q0 K4 V4       ONT  [illegible]  550P D9S 0
```

Apollo

```
WE 16DEC  P P
1  AS 106 F4 Y4 B4 04 M4          PDXONT  810A 1010A M80 B-B-  0
2: AA2516 Y4 B4 H4 04 M4 V4       PDXONT  715A 1029A 73S B-B-  1
3  AS 210 F4 Y4 B4 04 M4          PDXONT  720A 1045A 72S B-B-  1
4: AA2512 Y4 B4 H4 04 M4 V4       PDXONT 1004A  106P 73S S-S-  1
5  AS 176 F4 Y4 B4 04 M4          PDXONT 1220P  415P M80 L-L-  2
6  A$  84 F4 Y4 B4 04 M4          PDXONT  105P  425P 72S L-L-  1
7  AS 214 F4 Y4 B4 04 M4          PDXONT  625P  950P 72S D-D-  1
8  UA1245 F8 Y9 B9 M9 H9 04 V4    PDXONT  630P 1004P 737 D-S-  1
```

```
WE 16DEC  P P
1: AA2586 -4 B4 H4 04 M4 V4       PDXONT  728P 1035P 73S D-D-  1
2: AA2506 Y4 B4 H4 04 M4 V4       PDXSJC  640A  819A 73S B-B-  0
3: AA2054 Y4 B4 H4 04 M4 V4          ONT  859A 1004A 73S ----  0
4 7PS1856 Y4 B4 04 M4 V4          PDXSFO  600A  732A D9S B-B-  0
5 7PS1640 Y4 B4 04 M4 V4             ONT  800A  909A 146 ----  0
6  UA 125 F9 Y9 B9 M9 H9 09 V9X09 PDXSFO  630A  806A D8S B-B-  0
7  UA1169 F8 Y9 B9 M9 H9 09 V9      ONT  928A 1045A 737 ----  0
```

```
WE 16DEC  P P
1  AS 700 F4 Y4 B4 04 M4          PDXSEA  645A  725A M80 ----  0
2  AS 174 F4 Y4 B4 04 M4             ONT 1050A  115P M80 L-L-  0
3: AA2506 Y4 B4 H4 04 M4 V4       PDXSJC  640A  819A 73S B-B-  0
4: AA2512 Y4 B4 H4 04 M4 V4          ONT 1201P  106P 73S ----  0
5^ DL 448FN4YN4BN4 H40N4 M4KN4 L4 PDXSLC  550A  827A 72S B-S-  0
6^ DL1837 F4 Y6 B5 H4 04 M4 K4 L4    ONT 1106A 1140A 733 S-S-  0
7 6AS2450 Y4 B4 00 M0             PDXSEA  630A  713A SWM ---- *0
8  AS 174 F4 Y4 B4 04 M4             ONT 1050A  115P M80 L-L-  0
```

```
WE 16DEC  P P
1  HP 570 Y4 04 M4 K4 V4          PDXLAS  700A  845A 733 S-S-  0
2  HP 623 Y4 00 M0 K4 V0             ONT 1000A 1050A 733 ----  0
3^ DL1440 F4 Y6 B5 H4 04 M4 K4 L0 PDXLAX  700A  903A 72S B-B-  0
4^8DL5310 Y6 B5 H4 04 M4 K4 L0       ONT 1040A 1105A SWM ---- *0
5: AA2048 Y4 B4 H4 04 M4 V4       PDXSFO  700A  842A 73S B-B-  0
6: AA2146 Y4 B4 H4 04 M4 V4          ONT 1137A 1250P 73S ----  0
7: AA2516 Y4 B4 H4 04 M4 V4       PDXOAK  715A  851A 73S B-B-  0
8: AA2398 Y4 B4 H4 04 M4 V4          ONT 1145A 1256P 73S ----  0
```

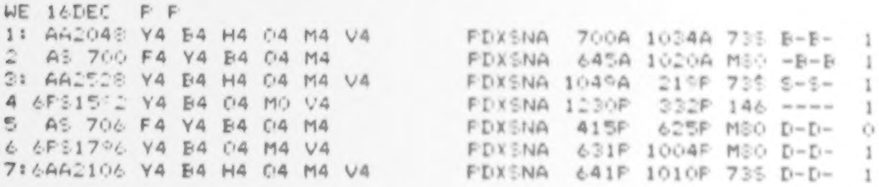
3. Portland-Orange County (Apollo)

The following example is from an Apollo display taken on December 3, 1987 asking for availability from Portland to Orange County at 7:00 a.m. Apollo shows non-stops and directs first, followed by connections. Apollo assembles a work area of sixteen flight items. Once the sixteen flight items have been selected, the flights are ordered based on least elapsed flying time (connections only) and departure time closest to the time requested. Keeping the above in mind while looking at this example, Apollo has specifically selected a United connection leaving at 6:30 a.m., arriving at 2:35 p.m. above the America West flight that leaves exactly at 7:00 a.m. and arrives at 11:35 a.m. - 2 hours earlier than the United flight.

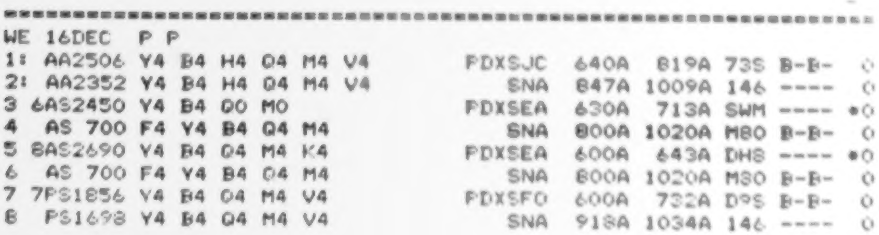
When asking for departures at 11:00 a.m., Apollo again sequences a United flight that leaves at 10:49 a.m., making three stops, arriving at 6:35 p.m., before the America West flight leaving exactly at 11:00 a.m., arriving at 2:50 p.m., or 3:45 hours earlier than the United flight.

This sequencing pushes America West to the fourth screen in each case, and in no way represents the better service.

7:00 a.m.



```
WE 16DEC  P P
1: AA2048 Y4 B4 H4 Q4 M4 V4        PDXSNA  700A 1034A 73S B-B-  1
2  AS 700 F4 Y4 B4 Q4 M4           PDXSNA  645A 1020A M80 -B-B  1
3: AA2528 Y4 B4 H4 Q4 M4 V4        PDXSNA 1049A  219P 73S S-S-  1
4 6PS1512 Y4 B4 Q4 M0 V4           PDXSNA 1230P  332P 146 ----  1
5  AS 706 F4 Y4 B4 Q4 M4           PDXSNA  415P  625P M80 D-D-  0
6 6PS1796 Y4 B4 Q4 M4 V4           PDXSNA  631P 1004P M80 D-D-  1
7:6AA2106 Y4 B4 H4 Q4 M4 V4        PDXSNA  641P 1010P 73S D-D-  1
```



```
================================================================
WE 16DEC  P P
1: AA2506 Y4 B4 H4 Q4 M4 V4        PDXSJC  640A  819A 73S B-B-  0
2: AA2352 Y4 B4 H4 Q4 M4 V4           SNA  847A 1009A 146 ----  0
3 6AS2450 Y4 B4 Q0 M0              PDXSEA  630A  713A SWM ---- *0
4  AS 700 F4 Y4 B4 Q4 M4              SNA  800A 1020A M80 B-B-  0
5 8AS2690 Y4 B4 Q4 M4 K4           PDXSEA  600A  643A DH8 ---- *0
6  AS 700 F4 Y4 B4 Q4 M4              SNA  800A 1020A M80 B-B-  0
7 7PS1856 Y4 B4 Q4 M4 V4           PDXSFO  600A  732A D9S B-B-  0
8  PS1698 Y4 B4 Q4 M4 V4              SNA  918A 1034A 146 ----  0
```

```
WE 16DEC   P P
1: AA2506 Y4 B4 H4 Q4 M4 V4        PDXSJC  640A  819A 73S B-B-  0
2: AA2342 Y4 B4 H4 Q4 M4 V4           SNA 1117A 1237P 146 ----  0
3 7PS1856 Y4 B4 Q4 M4 V4           PDXSFO  600A  732A D9S B-B-  0
4 6PS1782 Y4 B4 Q4 M4 V4              SNA 1021A 1137A 146 ----  0
5' DL 448FN4YN4BN4 H4QN4 M4KN4 L4 PDXSLC  550A  827A 72S B-S-  0
6' DL 235 F4 Y6 B5 H4 Q4 M4 K4 L0     SNA 1110A 1150A 757 L-L-  0
7  UA 125 F9 Y9 B9 M9 H9 Q9 V9XG9 PDXSFO  630A  806A D8S B-B-  0
8  UA3150 Y9 B7 M7 H5 Q5              SNA 1055A  235P SH6 -S-S *2
```

```
===========================================================================
WE 16DEC   P P
1  UA1261 F4 Y9 B9 M9 H9 Q9 V9     PDXLAX  650A  858A 737 B-B-  0
2  UA3523 Y9 B9 M9 H4 Q4              SNA  955A 1025A EMB ---- *0
3: AA2516 Y4 B4 H4 Q4 M4 V4        PDXOAK  715A  851A 73S B-B-  0
4: AA2348 Y4 B4 H4 Q4 M4 V4           SNA 1000A 1126A 146 ----  0
5  HP 570 Y4 Q4 M4 K4 V4           PDXLAS  700A  845A 733 S-S-  0
6  HP 653 Y4 Q0 M4 K4 V0              SNA 1045A 1115A 733 ----  0
7: AA2048 Y4 B4 H4 Q4 M4 V4        PDXSFO  700A  842A 73S B-B-  0
8: AA2132 Y4 B4 H4 Q4 M4 V4           SNA 1100A 1227P 146 ----  0
```

11:00 a.m.

```
WE 16DEC   P P
1: AA2528 Y4 B4 H4 Q4 M4 V4        PDXSNA 1049A  219P 73S S-S-  1
2 6PS1592 Y4 B4 Q4 M0 V4           PDXSNA 1230P  332P 146 ----  1
3  AS 706 F4 Y4 B4 Q4 M4           PDXSNA  415P  625P M80 D-D-  0
4 6PS1796 Y4 B4 Q4 M4 V4           PDXSNA  631P 1004P M80 D-D-  1
5:6AA2106 Y4 B4 H4 Q4 M4 V4        PDXSNA  641P 1010P 73S D-D-  1
6  PS1874 Y4 B4 Q4 M4 V4           PDXSFO 1044A 1225P M80 L-L-  0
7  PS1886 Y4 B4 Q4 M4 V4              SNA 1251P  208P M80 ----  0
```

```
===========================================================================
WE 16DEC   P P
1  PS1874 Y4 B4 Q4 M4 V4           PDXSFO 1044A 1225P M80 L-L-  0
2 6PS1684 Y4 B4 Q4 M4 V4              SNA  200P  317P 146 ----  0
3: AA2512 Y4 B4 H4 Q4 M4 V4        PDXSJC 1004A 1141A 73S S-S-  0
4:6AA2024 Y4 B4 H4 Q4 M4 V4           SNA  143P  256P 73S ----  0
5: AA2702 Y4 B4 H4 Q4 M4 V4        PDXLAX  955A  220P 73S ----  2
6:6AA5221 Y4 B4 H4 Q4 M4 V4           SNA  455P  528P SWM ---- *0
7: AA2702 Y4 B4 H4 Q4 M4 V4        PDXSFO  955A 1240P 73S ----  1
8: AA2144 Y4 B4 H4 Q4 M4 V4           SNA  430P  545P 73S ----  0
```

```
WE 16DEC   P P
1: AA2702 Y4 B4 H4 04 M4 V4        PDXLAX  955A  220P 73S ----  2
2:6AA5221 Y4 B4 H4 04 M4 V4           SNA  455P  528P SWM ---- *0
3:¯AA2702 Y4 B4 H4 04 M4 V4        PDXSFO  955A 1240P 73S ----  1
4: AA2144 Y4 B4 H4 Q4 M4 V4           SNA  430P  545P 73S ----  0
5: AÅ2528 Y4 B4 H4 04 M4 V4        PDXSFO 1049A 1232P 73S S-S-  0
6: AA2144 Y4 B4 H4 Q4 M4 V4           SNA  430P  545P 73S ----  0
7  UA 260 F8 Y9 B9 M9 H9 Q9 V9     PDXSFO 1049A 1225P 722 S-S-  0
8 6UA3156 Y9 B0 M0 H0 Q0              SNA  300P  635P SH6 -S-S *2
```

```
================================================================
WE 16DEC   P P
1  HP  28 Y4 04 M4 K4 V4           PDXPHX 1100A  215P 73S S-S-  0
2  HP 658 Y4 00 M4 K4 V0              SNA  245P  250P 733 ----  0
3  UA1289 F5 Y9 B9 M7 H7 07 V7     PDXLAX 1145A  143P 727 L-L-  0
4  UA3494 Y9 B9 M9 H4 Q4              SNA  300P  330P EMB ---- *0
5  HP  28 Y4 Q4 M4 K4 V4           PDXPHX 1100A  215P 73S S-S-  0
6  HP 660 Y4 00 M0 K4 V0              SNA  500P  505P 733 ----  0
7  AS 211 F4 Y4 B4 Q4 M4           PDXSEA 1100A 1140A 72S ----  0
8  AS 706 F4 Y4 B4 Q4 M4              SNA  205P  625P M80 -D-D  1
```

4. Moline-Orange County (SABRE)

A SABRE availability schedule was requested for 7:00 a.m. America West has two-stop service leaving at 7:05 a.m., arriving at Orange County at 11:35 a.m. The above America West service does not show because of SABRE's overlapping edit parameter. Northwest has a flight leaving after the America West flight at 7:45 a.m., arriving at Orange County before the America West service at 11:00 a.m. The Northwest service is 31 minutes and 20% faster than America West, therefore editing out the America West 7:05 a.m. departure. However, TWA's longer service that leaves at 8:01 a.m., arriving 1:10 p.m. is shown, as well as interline connections. The faster, on-line America West service does not show and will not be shown because of the overlapping edit parameter, thus not allowing the subscriber the option of offering the America West service.

```
116DECMLISNA7A
 16DEC  WED   MLI/CST      SNA/PST-2
SEE ALSO BUR/LAX/LGB/ONT
1UA 663 F4 Y4 B4 M4 Q0 H4 V0 MLIDEN  700A  802A 727 B 0 1A
2UA 801 F5 Y7 B7 M7 Q7          SNA  855A 1038A 733 S 0 1A
3NW1382 F4 Y4 B4 Q4 M4       MLIMSP  745A  840A DC9 0 XS 1A
4NW 111 F4 Y4 B4 Q4 M4          SNA  920A 1100A M80 B 0 1A
5TW 566 F4 Y4 M4 B4 Q4 V4 K4 MLISTL  801A  858A DC9 0 1A
6TW  65 F4 Y4 M4 B4 Q4 V4 K4    SNA 1110A  110P M80 L 0 1A
1*J
 16DEC  WED   MLI/CST      SNA/PST-2
SEE ALSO BUR/LAX/LGB/ONT
1UA*2864 Y4 B4 M4 Q0 H0         MLIORD  830A  920A F27 0 XJ 1A
2UA  453 F4 Y4 B4 M4 Q4 H4 V4      SNA  957A 1221P 733 L 0 1A
3AA*4220 Y7 B7 M7 H5 Q0 V0      MLIORD  110P  205P SH6 0
4AA 2096 Y7 B7 M7 H7 Q7 V3         SNA  250P  521P 733 D 0
5UA*2870 Y4 B4 M4 Q0 H0         MLIORD  200P  250P F27 0 1A
6UA  859 F4 Y4 B4 M4 Q4 H4 V4      SNA  358P  624P 733 D 0 1A
1*J
 16DEC  WED   MLI/CST      SNA/PST-2
SEE ALSO BUR/LAX/LGB/ONT
1UA 655 F4 Y4 B4 M4 Q4 H4 V4 MLIDEN  332P  434P 727 S 0 1A
2CO 587 F5 Y7 B7 M0 Q0          SNA  550P  724P 733 D 0 1A
3HP 444 Y4 K4 M4 Q0 V0       MLIPHX  305P  600P 735 S 1
4HP 664 Y4 K4 M4 Q0 V0          SNA  750P  755P 733 0
5NW 387 Y4 B4 Q4 M4          MLIMSP  435P  545P CVR 0 1A
6NW 117 F4 Y4 B4 Q4 M4          SNA  655P  833P M80 D 0 XJ 1A
```

5. Baltimore/Washington-Seattle (SABRE)

The following example was taken from a SABRE availability display requesting Baltimore/Washington-Seattle departures at 9:00 p.m. The America West service leaving at 9:35 p.m. and arriving at 4:00 a.m. does not show, and does not come under the overlapping parameters to be edited out. The America West schedule is the only service after 9:00 p.m. to Seattle.

```
115DECBWISEA9P]
 15DEC  TUE   BWI/EST      SEA/PST-3
SEE WAS FOR BWI/DCA/IAD
1UA 975FN4YN4 B4 M4 Q4 H4 V4 BWIORD  814P  910P D8S S/ 0 TA
2UA 151 F4 Y4 B4 M4 Q4 H4 V4    SEA  946P 1210A#1 D8S S 0 TA
3AA 119FN7YN7 H7 B7 M7 V7 Q7 BWIORD  758P  859P S80 S/ 0
4AA 673FN7YN7 H7 B7 M7 V7 Q7    SEA  940P 1207A#1 S80 S 0
5NW1291 F4 Y4 B4 Q4 M4       BWIDTW  552P  725P D9S S 0 XJ TA
6NW 581 F4 Y4 B4 Q4 M4          SEA  805P  950P 757 D 0 XJ TA
1*]
 15DEC  TUE   BWI/EST      SEA/PST-3
SEE WAS FOR BWI/DCA/IAD
1CO1633 F5 Y7 B7 M7 Q7            BWIDEN  540P  728P M80 D 0 TA
2CO  81 F5 Y7 B7 M7 Q7               SEA  835P 1022P AB3 S 0 TA
3UA 261 F4 Y4 B4 M4 Q4 H4 V4      BWIORD__510P  611P D10 S 0 TA
4UA 157 F4 Y4 B4 M4 Q4 H4 V4         SEA  653P  906P D10 D 0 TA
5EA 639 F5 Y5 H5 Q5 K5 D2 L5 B5 BWIATL  505P  649P 72S D/S 0 TA
6EA  92 F5 Y5 H5 Q5 K5 D2 L5 B5    SEA  734P  950P AB3 D 0 TA
1*]
 15DEC  TUE   BWI/EST      SEA/PST-3
SEE WAS FOR BWI/DCA/IAD
1AL  35 Y4 B4 Q4 M4 K4        BWIPIT  630P  721P 72S 0 TA
2UA 151F#4Y#4 B4 M4 Q4 H4 V4    SEA  808P 1210A#1 D8S S 1 TA
3AA 207 F7 Y7 H7 B7 M7 V7 Q7 BWIORD  447P  555P S80 S 0
4AA 127 F7 Y7 H7 B7 M7 V7 Q7    SEA  645P  917P S80 D 0
5TW 487 F4 Y4 M4 B4 Q4 V4 K4 BWISTL  446P  605P 72S D 0 TA
6TW 375 F4 Y4 M4 B4 Q4 V4 K4    SEA  650P  915P M80 D 0 TA
```

```
 15DEC  TUE   BWI/EST      SEA/PST-3
SEE WAS FOR BWI/DCA/IAD
1NW 629 F0 Y4 B4 Q0 M4               BWIMSP  410P  550P DC9 S 0 1A
2NW-751 F4 Y4 B4 Q4 M4                  SEA  710P  838P D10 D 0 1A
3DL 817 F4 Y4 B4 M4 Q4 H4 K4 L4 BWIATL  400P  548P 72S 0 1A
4DL 184 F4 Y4 B4 M4 Q4 H4 K4 L4    SEA  648P  857P 767 D 0 1A
5DL 743 F4 Y4 B4 M4 Q4 H4 K4 L4 BWIDFW  320P  543P 73S S 0 1A
6DL1707 F4 Y4 B4 M4 Q4 H4 K4 L4    SEA  647P  839P 72S D 0 1A
1*J
 15DEC  TUE   BWI/EST      SEA/PST-3
SEE WAS FOR BWI/DCA/IAD
1AA 247 F7 Y7 H7 B7 M7 V7 Q7 BWIDFW  316P  541P S80 S 0
2AA 541 F7 Y7 H7 B7 M7 V7 Q7    SEA  629P  839P S80 D 0
3NW 465 F4 Y4 B4 Q4 M4        BWIDTW  300P  431P 72S 0 1A
4NW 751 F4 Y4 B4 Q4 M4           SEA  520P  838P D10 D 1 1A
5UA 417 F4 Y4 B4 M4 Q4 H4 V4 BWIORD  145P  241P 72S S 0 1A
6UA 155 F4 Y4 B4 M4 Q4 H4 V4    SEA  334P  542P D10 D 0 1A
1*J
 15DEC  TUE   BWI/EST      SEA/PST-3
SEE WAS FOR BWI/DCA/IAD
1AA  425 F7 Y7 H7 B7 M7 V7 Q7 BWISEA 1258P  603P 72S LD 1
2UA  231 F4 Y4 B4 M4 Q4 H4 V4 BWIORD 1100A 1156A D8S L 0 1A
3UA  159 F4 Y4 B4 M4 Q0 H4 V0    SEA 1251P  302P D8S L 0 1A
4CO  446 F5 Y7 B7 M3 Q0          BWISEA 1140A  519P M80 LS 2 1A
5CO  446 F5 Y7 B7 M3 Q0          BWIPDX 1140A  401P M80 LS 1 1A
6AS*2817 Y4 B4 Q4 M4                SEA  500P  538P F28 0 XJ 1A
```

Senator METZENBAUM. Thank you very much, Mr. Beauvais.

Mr. Levine?

Mr. LEVINE. Good morning.

To help you understand how I formed my views on the CRS systems and the marketing——

Senator METZENBAUM. Get a little closer, please.

Mr. LEVINE. I am sorry, sir.

To help you understand how I have formed my views on the CRS systems and the marketing——

Senator METZENBAUM. Before we get into this, on the Chair's time, why is there a General George Rogers Clark Professor of Management? I was just wondering what that was.

Mr. LEVINE. An anonymous relative felt that Yale University's faculty would not be complete without a chair named in honor of their great, great, great——

Senator METZENBAUM. It just peaked my curiosity. [Laughter.]

Go right ahead. That was on my time.

Mr. LEVINE. To help you understand how I formed my views on the CRS systems, please let me tell you a little bit about my background. I have had an unusual opportunity to see the airline business as a scholar, as a government official, and as an airline executive and consultant.

In 1965, I wrote the first modern scholarly article urging airline deregulation. I recently analyzed what has gone on since in a long article in the Yale Journal on Regulation which I have supplied the committee, and ~~excerpts~~ which I have asked to be put in the record.

I was de facto chief of staff at the CAB during the period when the Board was implementing President Carter's deregulation policy. After leaving the Board, I experienced first-hand the impact of computer reservation systems on competition, both at Continental Airlines, where I was executive vice president of marketing before and after Texas Air's acquisition, and at New York Air, where I was president and CEO.

I returned to academic life in 1984. I am presently at Yale. As you know, I currently receive a substantial retainer to serve as a consultant to Texas Air Corporation on strategic marketing and management issues. My duties do not include representing Texas Air's views to any body of government and do not encompass my appearance here today.

I am also serving as an expert witness in a private antitrust suit relating to these issues, but my views in that suit are consistent with my views here, and they are in the record of that suit.

My testimony here today was solicited by the subcommittee. It has not been reviewed by Texas Air or by any private party. I am not being compensated for this testimony in any way by anyone. I appear here on my own behalf, as a private citizen and scholar, because the issues under discussion are important to preserving the benefits that consumers derive from airline deregulation. Thank you for inviting me.

Please let me summarize briefly the written testimony I have supplied for the record.

CRSs are an essential tool to travel agents operating in a complex environment of deregulated fares and hub-and-spoke connections, but they can create competitive problems when misused by airlines and travel agents.

CRSs can distort the results of competition between airlines in fares and schedules by making it easier to find and book flights on the airline that owns the CRS. CRSs help airlines to monitor travel agents who agree to steer customers to them in return for hidden commission payments. Customers are unaware of this and think agents offer them unbiased advice.

CRSs help the airlines that own them get better information about travel agents' practices and competitors' market results than is available to non-owner airlines. They can use this information to distort the feedback that non-CRS airlines receive in response to marketing initiatives.

CRSs have helped to entrench the market positions of the airlines which were the two largest under CAB route regulation. Their favored position under CRS route regulation helped entrench American and United in the CRS market. And their CRS market positions have helped them maintain their positions in deregulated airline markets. Their positions in the CRS market are difficult to displace because liquidated damage and so-called "rollover" clauses tie existing CRS users to their present systems. Would-be airline competitors with CRSs can attempt to compete with American and United getting travel agents to switch, but this requires compensating the travel agents for the costs these clauses impose. Buying out these clauses artificially raises competitors' costs, an effect which has been recognized by academic commentators as an anticompetitive tactic.

CRSs also permit those airlines that own them to raise the costs of competitors who do not own them by charging them booking fees much higher than what it costs to operate the systems. These are serious allegations. How do we know they are true?

The most important piece of evidence is that airlines which own CRSs often provide systems to travel agents at below cost prices. Indeed, they sometimes pay to put their CRS into an agency. This is not evidence of healthy competition for access to travel agents. It simply replaces misleading information given customers by travel agents using one CRS system with misleading information gotten from another, with the travel agency and the CRS owning airlines sharing the spoils.

Airlines pay travel agencies bonuses of 30 to 40 percent and more over regular commission levels in order to induce them to steer clients' business in their direction. These extra commissions are not ordinarily disclosed to the client who thinks he or she is getting unbiased advice from the agent. If the agent does not possess the power to direct the traveler's choice, as is frequently claimed, why do the airlines pay these commissions?

The most effective and attractive bonuses are paid as part of "relationship" packages to travel agents whose booking activities can be monitored because they use the airline's CRS. CRS-owning airlines charge participants booking fees that range from about $1.80 to about $2.10 a booking. This raises the cost to non-owning airlines of doing business through automated agencies. Most estimates place the cost to the system owner of providing that service in the range of 50 to 75 cents a booking.

Senator METZENBAUM. Mr. Levine, the light has gone on, but since you took some time to explain the potential question that might be raised as to conflict of interest, we will give you another minute or two.

Mr. LEVINE. Thank you.

What should Congress do about these practices? First, do not re-regulate the whole industry to deal with the competitive problems created by CRS's. Price and entry regulation would cost consumers billions of annual dollars in benefits they have reaped since 1978.

You might consider new CRS rules. But new CRS rules would simply be a new challenge to a very ingenious group of airlines. The 1984 rules were a valiant regulatory attempt to eliminate the distortions I have described. They may have discouraged the most obvious practices, but the persistence and even growth of payments to switch systems suggest that choice-distorting practices continue.

As long as airlines own CRS's, they can benefit from the incremental revenues that can be created by distorting travel choices. As long as they can benefit from the incremental revenue, they will find a way to reap it. Further regulation is unlikely to solve the problem.

We ought instead to eliminate the socially perverse incentives created by airline ownership of CRS's. Congress should prohibit ownership of CRS's by airlines. This would eliminate the incentive to earn incremental airline revenue by misusing the CRS and eliminate the need for ever-more-complicated regulations. Rules similar to those which now exist could then be applied to the new, non-airline owners to eliminate any temptation to sell biased displays to individual airlines.

Non-airline CRS owners would then concentrate on making their systems as useful to travel agents as possible through presentation and functions, and as useful to airlines as possible by providing market information to airline users. Divestiture is practical, for reasons set out in more detail in my written statement.

Agencies as well as CRS owners should be relieved of the incentive to bias their advice to customers. A regulation requiring agents to disclose commissions above the standard rate would greatly inhibit their ability to steer customers. A travel agent who once has to tell a traveler, "I put you on American, rather than United, but don't think I was influenced by the extra 50 percent commission bonus American is paying me," is not likely to get the opportunity to repeat the experience.

I think we ought to control liquidated damages and make lock-in provisions unlawful, Senator, but I believe that fixing those aspects will not solve the whole problem; it will simply give airlines a more even chance to induce travel agents to distort information to consumers. We need to get at the roots of the problem. I think we need divestiture and I think we need disclosure of incentive commissions.

I am sorry, if I have been confusing or incomplete; I covered a lot of ground quickly. Thank you.

[The prepared statement and article from the Yale Journal by Mr. Levine follow:]

AIRLINE COMPUTER RESERVATIONS SYSTEMS AND MARKETING PRACTICES

TESTIMONY OF MICHAEL E. LEVINE

BEFORE

THE ANTITRUST SUBCOMMITTEE
COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE
DECEMBER 10, 1987

Good morning, Mr. Chairman and members of the Antitrust Subcommittee. My name is Michael E. Levine. I am General George Rogers Clark Professor of Management at Yale University, and I am pleased to have been invited by this subcommittee to present my views on the impediments to airline competition imposed by computer reservations systems and the marketing practices associated with them.

It might help in understanding my views on computer reservations systems and the marketing practices associated with them if I tell you a little bit about my background. It has given me an unusual opportunity to observe the airline industry as a scholar, as a government official making and implementing policy and as a senior executive and consultant to airlines. I have studied competition in the airline industry since 1965, when I wrote the first modern scholarly article urging airline deregulation. I have since published numerous scholarly articles, op-ed pieces and guest editorials on the subject. My most recent scholarly effort is an extended study published in the Spring, 1987 issue of the Yale Journal on Regulation, which addresses in some detail the subject of today's hearings and will form much of the basis of my testimony. I have supplied the article to the

Subcommittee and excerpts are attached to my testimony, along with a copy of my curriculum vitae.

In 1978 and 1979, I served as de facto chief of staff[1] at the Civil Aeronautics Board under Alfred Kahn and then Marvin Cohen, during the period when the Board was implementing President Carter's deregulation policy. For this work, I received the Board's Award for Excellence and Distinguished Public Service. After leaving the Board, I was exposed first-hand to competition in the deregulated industry and to the impact of computer reservations systems, first as a consultant and then as an executive. My executive career involved stints as Executive Vice President, Marketing at Continental Airlines, both before and after it was acquired by the Texas Air Corp., and as President and Chief Executive Officer at New York Air.

Upon my return to academic life in 1984, I resumed consulting for airlines and public bodies. As you know, I currently receive a substantial retainer to serve as a consultant to the Texas Air Corporation on strategic, marketing and management issues. My duties do not include representing Texas Air's views to any body of government, and do not encompass my appearance here today. Separately from that consulting arrangement, I have been engaged by the law firm of Cravath, Swaine and Moore to serve as an expert witness in a private antitrust suit against American and United Airlines alleging anticompetitive practices and effects in the use of their computer reservations systems. Among the plaintiffs in that suit are Continental and New York Air. My views on the issues raised in that suit are a matter of public record as a result of depositions taken in the case. They are entirely consistent both with the scholarly work I have published and the views I am expressing here today.

---

[1] My titles were: first, Director of the Bureau of Pricing and Domestic Aviation (which was responsible for, among other things, international and domestic rates, domestic route licensing, mergers, agreements and unfair competition, subsidized local service and certain international negotiations); later, I was General Director, International and Domestic Aviation.

My testimony today was solicited by the Subcommittee. It has not been reviewed by the Texas Air Corporation or anyone else. I appear here on my own behalf as a private citizen and scholar, because the issues under discussion are important to preserving the benefits consumers derive from airline deregulation. I am not being compensated for this testimony in any way by anyone. Thank you for inviting me.

Computer reservations systems ("CRS's") are an essential tool for travel agents operating in a complex environment of deregulated fares and hub-and-spoke connections. But they can create competitive problems when misused by airlines and travel agents.

CRS's can distort the results of competition between airlines in fares and schedules by making it easier to find and book flights on the airline that owns the CRS.

CRS's help airlines to monitor travel agents who agree to steer customers to those airlines in return for hidden commission payments. Customers are unaware of this and think agents offer them unbiased advice.

CRS's help the airlines that own them get faster and in some cases more complete information about travel agent sales patterns and competitor's market results than is available to non-owner airlines. They can use this information to distort the feedback that non-CRS airlines receive in response to marketing initiatives.

CRS's have helped to entrench the market positions of the airlines which were the two largest under CAB route regulation. These positions are difficult to displace because liquidated damage and so-called "rollover" clauses ties existing CRS users to their present systems. Buying out these clauses raises competitors' costs.

CRS's permit those airlines that own them to raise the costs of competitors who do not by charging them booking fees much higher than what it costs to operate the systems.

These are serious allegations. How do we know they are true?

Deregulation has created an explosion of possibilities in travel. Customers wish to choose from seats available in many thousands of city-pair markets sold in a mind-boggling number of combinations on thousands of connecting flights every day for up to a year in advance. Each seat has associated with it several to many fare possibilities which vary depending on the rest of the customer's itinerary and other journey characteristics designed to facilitate market segmentation.

Some conduit is needed to give customers access to the enormously complicated inventory from which they make their travel choices. This information was once made available in a telephone book-sized document detailing for travel agents and customers the schedules and fares available. But schedules now change quickly and connecting possibilities have mushroomed, making such a document difficult to use even for trip planning. The fares available are so numerous and change so quickly that they can no longer even be listed; the flights on which they are available and the quantities of seats on each flight to which they apply are changed daily.

Electronic assistance in making a frequently updated data base available to customers through travel agents is a necessity in this environment. Over 90 per cent of tickets sold through travel agencies are sold through CRS's. Economies of scale and information, including training requirements, mean that most travel agents use only one system. Virtually all airlines have found it necessary to list their flights and fares in all electronic systems so that they can reach the customers of all travel agents.

Travel agents who use an airline-owned computer reservations system are more likely to book passengers on the flights of the airline that owns the system than on the flights of competitors. Since there is no reason to think that the preferences of an agency's customers change depending on the computer system being used, it must be the case that airline-owned CRS's facilitate shifting some customers from flights they would otherwise have selected onto the flights of the system-owning airlines.

— They do this in several ways, with and without the cooperation of the travel agents using the system:

First, notwithstanding rules addressing the issue, subtle biases continue to exist in the way flights are displayed in response to travel agent requests and in the ease with which a travel agent can get information about the CRS-owners flights compared to the flights of other airlines. These biases include the choice of the algorithms that determine in what order flights will be displayed on the screen, the choice of connecting points and criteria that determine how a passenger will use the hub-and-spoke systems that have become characteristic of deregulated airlines, the ability to book popular flights (so-called "last seat availability"), and the ease with which a travel agent can access information about airlines other than the system owner.

Travel agents operate on thin margins and are under constant pressure to improve productivity. A travel agent trying to achieve maximum productivity will tend to use information as it is presented to her or him by the computer system. In fact, American airlines estimated in an internal document that about half of SABRE bookings were made from the first line of the display and about 80 percent from the first three lines. CRS-owning airlines know this and make heroic efforts to induce travel agents to use their system rather than some other.

These efforts are impeded by practices designed to "lock-in" an agency to a system once it is selected. This entrenches unfairly those airlines such as United and American whose prederegulation route systems gave them an advantage in setting up CRS's in the first place.

CRS's seem to dominate the geographic areas centered on hubs dominated by the airlines that own them. Geographic computer domination is worth more to an airline that has many flights originating in that region for which the computer system can enhance revenue. And the complementary character of the economies of scope and scale involved in hub-and-spoke systems, frequent flyer programs and travel agent incentive commission programs find parallels in and are enhanced by the economic characteristics of these systems.

Since American and United were awarded the largest route systems under regulation, they had a natural advantage in developing and selling CRS's to travel agents. While their systems have been replaced at many travel agencies located in hub areas dominated by other CRS-owning airlines, they remain dominant in those cities and regions which are predominantly spokes on other hub systems, rather than having hub airports of their own. Since these are the cities at which airline competition between hubs is fiercest, American and United have a considerable advantage over their later-starting, regulation-limited competitors. Their initial advantage, coupled with the "lock-in" contractual provisions, has tended to perpetuate their dominant position.

But any CRS will particularly distort competition between airlines competing for traffic at "spoke" cities. At these cities, the choice of hubs at which connections will be displayed in response to a travel agent request is particularly critical to agent and customer choice of carriers. There are so many possible connections that no system can be required to display them all. No rule, including the current DOT one, relating to connecting algorithms can possibly eliminate bias.

Lock-in practices, such as long terms, liquidated damage clauses and "rollover" clauses, further distort competition among airlines owning systems. Liquidated damage clauses obligate a travel agency to pay the CRS provider a sum of money intended to compensate it for the lost incremental profits that might have been earned from booking-fee and other revenue sources over the life of the contract. In legal terms it protects the expectation interests rather than the contracting costs of CRS owners, even though there is no evidence that placing a terminal in one travel agency diminishes the possibility of putting one in another. Contracting costs consist only of unamortized installation costs and training costs, plus removal costs.

Roll-over provisions require that an agency sign up for an extended term (often the same length as a new one) every time it adds a new piece of hardware or a new service. A growing location finds itself almost perpetually at the beginning of its contract term.

CRS lock-in practices are undesirable.[2] They inhibit competition between system owners for a more equal share of the CRS business. Lock-ins make it difficult and expensive for one CRS system to replace another at a travel agency location. The expense of "buy-outs" represents a form of the practice of raising rivals' costs which has been identified by recent theorists[3] as a new form of predation.

But the Subcommittee should keep in mind that the contest inhibited by lock-in practices is not itself benign: the competition which is unfairly distorted by lock-in practices is competition by CRS-owning airlines for the right to join with travel agents in distorting consumer choice.

For example, a CRS helps its airline owner use more effectively marketing practices like incentive or override systems which pay travel agents undisclosed extra commissions for steering customers to one airline rather than another. Unsuspecting customers requesting advice from travel agents who purport to sell the inventory of the entire industry are frequently encouraged to use the flights of the CRS-providing airline. The airline pays travel agents for success in shifting business according to formulas which reflect the amount of business done on other carriers, as well as that done on the "incentivizing" airline. The airline whose CRS is used by the travel agent can monitor the performance of the agent in moving traffic from other airlines to its own flights, and can do this monitoring on a daily basis, practically in "real time" if necessary. Of course, override commissions can be paid by an airline without a CRS, but it cannot monitor agency performance nearly as effectively.

---

[2] Commitments designed to make it expensive for contracting parties to separate have an important economic function in contexts where the withdrawal of one party after commitment will inflict significant damage on the other. O. Williamson, The Economic Institutions of Capitalism, 163-189 (1985). In such situations, it may be efficient for contracting parties to arrange "hostages" that might resemble superficially the lock-in provisions seen in the CRS context. Where a CRS provider has invested in a switchover from one system to another, lock-in provisions might function to protect that investment. But even here, it would be preferable from a public policy standpoint to impose only liquidated damages designed to cover that investment, rather than the stream of future earnings. Since neither the agency nor the airline will be damaged beyond the costs of installation and removal by the substitution of one CRS for another, lock-in terms appear to function in the CRS context only to as impediment to access by other CRS systems to customers of dominant systems.

[3] Salop and Scheffman, "Raising Rival's Costs" 73 American Economic Review Papers and Proceedings 267 (1983)

An airline which controls the system on which travel agents makes bookings on itself and its competitors gains market intelligence because it receives real-time information about market preferences and the success of marketing initiatives. An airline without access to the information generated by such a system knows only the travel patterns of those who buy its tickets. Older market data is available from the Department of Transportation, but this data is deliberately delayed by nine months to minimize the disclosure of competitively sensitive -- (that is, immediately useful) information.

Alternatively, the airline can have employees count passengers boarding or deplaning at rivals' airport gates, but such observation is expensive and doesn't provide any of the most valuable information. "Counting" flights at a hub does not reveal the true origins and destinations of those boarding a plane, nor does counting at a spoke. Class of service can not be observed this way, nor can price and discount categories for tickets. In an era of hub and spoke route systems and complex fare structures, it is extremely difficult to estimate the revenue a rival's flights generate by looking at passenger counts. For the same reasons, it is difficult to discern the success or failure of a fare initiative, advertising program, or service change without better data than can be obtained by crude observation.

In contrast, an airline whose CRS is used by travel agents has access to a very accurate picture of both its own and its rivals' business patterns. Through the CRS an airline can track the effect of price changes, see roughly how much of a rival's seat inventory is assigned to a given discount fare classification, measure how much full-fare business it attracts compared to rivals, and track changes in shares of city-pair traffic flows and of market demand subsegments. It can even see how loyal its own frequent flyers are. A CRS owner can then use this information to distort market signals to its rivals, leading them to make incorrect decisions. When a CRS owner sees travel agents making bookings on a rival airline's flights, it can intervene through targeted secret incentive programs in an attempt to switch business. By responding selectively, it can temporarily distort signals the market sends to competitors, in order to persuade the rival to abandon fares, schedules or even routes where, absent these secret interventions, its offerings would be preferred by customers.

This power of observation assists the CRS owner in its own efforts to attract business by distorting efforts of travel agencies. In a sense, the computer system gives its owner a technological advantage over rival principals in monitoring the behavior of agents for whose allegiance they compete. A travel agent has two sets of principals: the travelers who use his services and the airlines whose tickets he sells. Incentive commission programs attempt to induce the agent to breach his responsibility to travelers in favor of a particular airline.

Without a computer reservation system on which an agent makes all his bookings, it is difficult for an airline which has signed an incentive commission agreement with an agent to know what effect the program has had or even whether the agent is complying with its terms. In an industry of considerable fluctuation and uncertainty, it is easy for a travel agent to claim falsely that disappointing results should be attributed to slow business at that location, or that the disappointing revenue he gives the airline in question represents the required percentage of his total bookings. In fact, it is not difficult for an agency to find a way to participate in the incentive programs of several competing rivals, making it an agent for multiple principals, all of whom it is shirking.

Data from CRS's obviously facilitate monitoring by airlines. If a travel agency makes all its bookings on an airline's system, rewards can be constructed based on actual performance, and "cheating" by the agent is difficult indeed. An absence of cheating presents competitors with fewer opportunities to contest markets.

But don't the CAB/DOT rules require system owners to make this information available to subscriber airlines? Yes, but only in the form of whatever written reports are used by the CRS-owning airlines. In practice, CRS owners make the information available to other airlines on a basis which introduces a substantial delay into the use of the data and which requires expensive customer reprocessing of data which has already been sorted. The CRS-owning airline can use its data base to monitor travel agents or markets as frequently as it wishes just by calling the information up on a terminal. This allows much faster response to a fluid deregulated marketplace.

What should be done about these practices? The 1984 rules were a valiant regulatory attempt to eliminate these distortions. They may have discouraged the most obvious practices, but the persistence and even growth of payments to switch systems suggests that the choice-distorting practices continue. As long as airlines own CRS's, they can benefit from the incremental revenue that can be created by distorting traveler choices. Further regulation is unlikely to solve the problem.

Congress should prohibit ownership of CRS's by airlines. This would eliminate the incentive to earn incremental airline revenue by misusing a CRS, eliminating the need for ever-more-complicated regulations. Rules similar to those which now exist should then be applied to the new, non-airline owners to eliminate any temptation to sell bias to individual airlines. CRS owners would then concentrate on making their systems as useful to travel agents as possible through presentation and functions and as useful to airlines as possible by providing market information to all airline users.

Although it has been argued that CRS divestiture is impractical, it is not obvious why this should be the case. Eliminating competition from CRS's whose principal source of revenue was customers diverted by system effects would allow system owners to charge travel agencies fees, which, along with booking fees, would make CRS's potentially profitable. While it is not necessarily the case that all five systems now in significant use would survive independently, it would be quite possible once free of airline tying effects to create one or two viable competitors for SABRE and Apollo from SystemOne, Pars and DATAS. While it is true that many of these systems perform internal as well as travel agent functions for their airline owners, those functions could be separated or contracted from the new owners of the CRS. This is exactly the choice which faces non-owner airlines today.

Just as airline relationships with CRS's should be restructured to eliminate the incentive to bias CRS's, agencies should also be relieved of the incentive to bias their advice to customers. Regulating commission rates is probably undesirable on balance. But requiring agents to disclose commissions above the standard rate would greatly inhibit their ability to steer customers to an airline. A travel agent who once has to tell a traveler, "I put you on American rather than United, but don't think that I was influenced by the extra 50% commission bonus American is paying me," is not likely get the opportunity to repeat the experience.

CRS "Lock-in provisions" ought to be made unlawful. Liquidated damages should be limited to recovery of unamortized installation and training charges and the cost of equipment removal. This change and the elimination of rollover clauses would certainly improve access to travel agents by competing CRS vendors, and are worthwhile for that reason. But changing liquidated damage or rollover clauses without changing agent and airline incentives will simply equalize competition among CRS owners, without necessarily benefitting the public. These measures will not result in less biased information for the public unless they are accompanied by CRS divestiture and/or incentive commission disclosure.

I recognize that the issues you are addressing are complex. But they are also important. Airline deregulation has brought great benefits to the public. Some of these benefits have occurred in spite of, rather than because of, the inhibiting effects on competition of CRS's and the marketing practices they support.

Reregulation of price and entry on the Congress has been mentioned as a cure for the lingering imperfections of airline deregulation those with poor memories of the rigidities and absurdities of the ancien regime. Such a policy reversal would be short-sighted in the extreme, since it would reduce or eliminate many of the real benefits brought about by deregulation. It would put the Congress in the position of the owner of the goose that laid golden eggs.

The positions I am urging on you today -- airline divestiture of CRS's and travel agent disclosure of incentive commissions -- may seem radical. They are not. They constitute the simplest, least regulatory things that Congress can do to increase competition in the deregulated airline industry. Please consider them carefully as a measured, restrained course between two radical alternatives -- first, a return to detailed regulation with its concomitant reduction in the adaptability of the system to public demand and second, continuation of a laissez-faire system which allows airlines and travel agents deliberately to mislead customers.

Thank you for inviting me to testify.

Yale Journal on Regulation

Volume 4, Number 2 Spring 1987

Michael E. Levine

Airline Competition in Deregulated Markets: Theory, Firm Strategy, and Public Policy

4 YALE J. ON REG. 393

Copyright © 1987 by the Yale Journal on Regulation, Yale Law School, 401A Yale

The relationships between airlines, travel agents, travel agent incentives, commission override[96] programs, and airline computer reservations systems used by travel agents, when addressed at all in the context of deregulation, were discussed as a byproduct of the CAB-sanctioned system.[97] In this system, entry-controlled airline-accredited travel agents issued tickets for fares fixed by the CAB at above-cost levels and were compensated by means of CAB fixed commission rates. Although overrides became common once commission rates were deregulated, it was assumed, incorrectly, that they would disappear once competition drove fares to cost, freer entry into the agency business eliminated excessive commissions, and alternative distribution systems freed both airline and customer from heavy reliance on travel agents.

G. *Computerized Travel Agent Reservation Systems*

The central role played by computerized travel agent reservation systems (CRSs) is another unanticipated phenomenon of the deregulated environment which requires further explanation. A travel agency uses a CRS provided by an airline to get flight and fare information for its customers, issue tickets and boarding passes, and provide ancillary services such as rental car and hotel reservations. Either because of economies of scale or because of contractual terms, an agency usually uses only one system. The six largest domestic airline systems all own CRSs (Northwest and TWA jointly own PARS, so there are five systems). The CRSs owned by two airlines, United and American, are used by seventy percent of travel agencies; of all airline tickets sold, fifty-seven percent are sold through CRSs.[98]

CRSs have been used to distort information received by travel agents and consumers about the service offerings of rival airlines.[99] Travel agents have benefited from the proliferation of fares, airlines, and services by gaining a tight hold on the retail distribution system. Overrides have

---

1985, after seven years of deregulation. While there is some doubt as to whether this data is correct in absolute terms, there is little doubt that the proportion of domestic tickets issued by travel agents has increased substantially since deregulation. (Private communication by author with David Swirenga, Air Transport Association of America).

[96] "Commission override" denotes incentives in the form of special services or extra commissions given to encourage travel agents to sell seats on a particular airline.

[97] The relationships were controlled by industry agreements in the form of Air Traffic Conference resolutions sanctioned by the CAB. After a CAB investigation, the antitrust exemption for these agreements was ended in 1984. *See* CAB Investigation into the Competitive Marketing of Air Transportation, Order 82-12-85; [hereinafter Competitive Marketing]. For a description of the agreement, see Ass'n of Retail Travel Agents, Ltd. v. Air Transport Ass'n of America, 623 F.Supp. 893 (D.D.C. 1985).

[98] United Airlines v. Civil Aeronautics Bd., 766 F.2d 1107, 1109 (7th Cir. 1985).

[99] *Id*. at 1110 (1985).

proliferated in a domestic market in which they were previously illegal and almost unknown.[100] Airlines with a large volume and variety of flights at a city—"presence" in industry marketing jargon—can create more effective override programs than can their competitors. Airlines that combine both market presence and precise information about competitors' activities provided by having the bookings of competitors made on their own CRSs can employ incentive programs very effectively indeed.

Since deregulation, these unexplained phenomena have generated a major CAB rulemaking,[101] a further Department of Transportation (DOT) investigation,[102] at least three private antitrust suits which have been consolidated into a multi-district litigation,[103] and calls for laws or rules requiring divestiture of computer reservations systems by their airline owners.[104]

H. *Slots and Gates*

Airport slots and gates were identified relatively early by those interested in deregulation as important to the functioning of a competitive airline system.[105] Concern has largely focused on mechanisms to avoid slot and gate waste, thus freeing these often very scarce resources to flow to their most valuable use. Concerns have also arisen about the availability of slots and gates and whether new entrants or expanding airlines could acquire them on competitive terms.

These concerns are important in their own right and resolving them successfully is a necessary condition for contestability to produce an equilibrium resembling that of competition. But the obsession to acquire and hold slot and gate portfolios, exhibited both by holders of gates and slots and those who wish to acquire them, requires further explanation. Such revenue-generating benefits that appear to be even more important to survival than, for example, fully competitive production costs.

---

[100] Overrides have always been common, though not always legal, in international markets.

[101] Carrier-Owned Computer Reservation Systems, 49 Fed. Reg. 32,540, 32,562-64 (1984) (codified at 14 C.F.R. Pt. 255 (1986)).

[102] *DOT Opens Computer Reservations System Investigation*, AVIATION DAILY, Feb. 3, 1987, at 1.

[103] *In re* Air Passenger Computer Reservation Systems Antitrust Litigation, MDL-667 (C.D. Cal. consolidated Jan. 31, 1986), *consolidating* New York Airlines, Inc v. American Airlines, Inc. and United Air Lines, Inc., CV86-0697 (N.D. Cal. Jan. 31, 1986), Continental Airlines, Inc. and Texas International Airlines, Inc. v. American Airlines, Inc. and United Air Lines, Inc., CV86-6096 (N.D. Cal. Jan. 31, 1986), USAir, Inc. v. American Airlines, Inc. and United Air Lines, Inc., CV84-8918 (C.D. Cal. Nov. 20, 1984), and Pacific Express, Inc. v. United Air Lines, Inc., CV84-5185 (C.D. Cal. Jul. 13, 1984).

[104] *Senate Comm. on Commerce, Science and Transportation, Subcomm. on Aviation, Hearings on Computer Reservations Systems*, 99th Cong., 2d Sess., March 19, 1985 (Statement of Alfred E. Kahn).

[105] D. GRETHER, R. ISAAC & C. PLOTT, ALTERNATIVE METHODS OF ALLOCATING AIRPORT SLOTS: PERFORMANCE AND EVALUATION (1979) (Study prepared for the Civil Aeronautics Board by Polinomics Research Laboratories, Inc., Pasadena, Calif.); Levine, *supra* note 5, at 1417.

The brief explosion between 1978 and 1984 of new entry by firms without established brands offering products which were in many respects non-standard has had the paradoxical result of reinforcing the information effects described here. A period of very intense news coverage of airline deregulation created information about the presumed advantages of new entrant airlines that was *not* firm-specific. New entrant airlines, through their advertising and the publicity they received, linked their brand offerings to this flood of non-firm-specific information. This generated a great deal of initial trial. Many new airlines offered new services at new fares.

Unfortunately, the resulting marketplace confusion ultimately placed a premium on efficient brand-specific communication. Consumers found it difficult to search through the available possibilities and were hampered in their searches by travel agents biased by incentive programs and dependent upon biased CRSs for information. Established brands with extensive route networks and standard products had less new information to communicate and could take advantage of the economies we have discussed by communicating it over broader scale and scope. They also had incentive programs and often CRSs of their own, or they could at least deal with the CRS owners on more favorable terms than the new entrants could. And the failure of many new airlines with new product concepts, costing customers money and disrupting travel plans, created a kind of negative external effect on other novel brands and a real goodwill premium in the older brands offering a standard product.

2. *Principal-Agent Effects*

Economies of scope in exploiting principal-agent problems have produced incentives for consolidation and have played a key role in firm strategies to generate rents in deregulated airline markets. The principal-agent problems which have been exploited by airlines are those that exist between the business traveler (agent) and her employer (principal) and between the travel agency (agent) and its traveling customers (principal). Both have been made the focus of airline marketing programs designed to reward the agent for directing business to the airline at the expense of the principal paying for the tickets.

These issues interest the analyst trying to understand the trend toward consolidation because both frequent flyer programs and travel agent incentive programs exhibit economies of scope which can be exploited most easily by large national firms.[143] Put simply, reward structures to agents can be designed to present them with economies of scale and scope. Most frequent flyer programs and travel agent incentive programs have non-linear reward structures.[144] This somewhat artificial economy of scale to the flyer makes it possible for the airline to benefit from economies of scope. The more destinations an airline offers a frequent flyer, or the higher proportion of total traffic volume from a city susceptible to being switched by a travel agent to the airline offering the incentives, the easier it is to earn the more desirable travel awards or higher percentage override commission payments. In addition, of course, the larger the portfolio of destinations offered to frequent flyers, the more likely it is that the frequent flyer will find a reward destination that attracts her.

Consider the plight of an airline specializing in transportation between two or three industrial cities, and competing for business at one of them with a national brand hubbing at that city. Such an airline would have to match the incentives offered by the national brand airline to both the traveler and the travel agent. A traveler on the specializing airline would have to fly very frequently between the few cities served by the specialist to earn enough mileage to matter—and then can use it only to take *another* trip between those cities! Rather than use the specialist, she clearly would prefer to concentrate her travel on an airline serving those cities and many others, including a few exotic ones.

The specializing airline would be at an equal disadvantage in providing incentives to a travel agent. Incentive programs for travel agencies are constructed to pay extra commissions both for increased market share in particular city-pairs and for increased total business or total market share of tickets generated by the agency. To equal the impact of the additional commission revenue that the hubbing airline would pay on its total business for incremental business in this market, the specialist would have to pay a prohibitively high commission rate for incremental business on its own routes. While it might be possible to negotiate with other small airlines at the city to offer jointly commission bonuses on all business booked by travel agents on any of them, such arrangements would be very costly transactions to arrange and maintain.[145] A consolidation into a firm with a national frequent flyer network and a substantial volume of commissionable business at the city in question is a natural way to overcome this competitive disability, and is likely to outweigh any production cost advantages that the smaller firm might have.

---

[143] *See, e.g.*, the explanation for the AirCal-American merger offered by AirCal's President, David Banmiller, in Chandler, *When East Eats West*, FREQUENT FLYER, March 1987, at 82.

[144] Frequent flyer programs increase the reward per mile flown, as the total miles flown on the airline increases. This non-linear reward structure creates incentives to concentrate travel on a single or limited number of airlines. Frequent flyer programs are discussed in detail *infra* Part IV-E.

[145] The small airlines attempting to coordinate would incur as a minimum the costs of arranging the consortium, free-rider problems which could be imposed on the other members by carriers doing more business at lower margins or by special incentive programs in response to a particular competitive threat, problems of joint financial responsibility for commission payments if one of the consortium

3. *Production Indivisibilities*

While there may not be significant production indivisibilities in producing aggregate capacity at the level of the firm, serving traffic flows between particular pairs of cities does involve substantial indivisibilities. Because these indivisibilities exist, it is necessary to sell the joint city-pair transportation products produced by a single flight connecting to a hub in a number of markets at different prices.[146] An airline's success in generating rents depends upon its ability to extract the highest possible revenue from the segmented traffic markets it mixes on the same aircraft.[147] Hub size helps do this in ways we will discuss *infra* Part IV-C. But consolidations at a hub, and consolidations to create multiple hubs, can do this as well.

To see how, consider two different airline and seat allocation problems. First, consider two airlines providing competitive service from their hubs, say at Minneapolis/St. Paul, to a relatively small spoke city, say Bismarck, North Dakota. The number of high-priced travelers needing transportation from Bismarck at any given time could be accommodated at all but peak periods in one aircraft, but in order to compete for business passengers with diverse and uncertain travel needs, each airline must offer several evenly spaced departures per day to the hub. Passenger preferences given the existing technology require that each airline must use jet aircraft with approximately one hundred seats in order to gain market acceptance in competition with other jet aircraft. The result of these schedule and equipment indivisibilities will be a very substantial number of seats not required by time-sensitive business travelers, which will have to be made available at a discount in the Bismarck-Minneapolis market.

---

members went out of business, and the problems of reorganizing the group when airlines entered or left particular city-pair markets or left the city entirely. In addition, the small airline consortium would have difficulty communicating with travel agents, who would find keeping track of the consortium members and their routes a lot more expensive than simply participating in the incentive program of the biggest airline in town, an information expense that would have to be compensated for in the consortium's commission rates.

[146] *See infra* Part IV-C.

[147] Airlines "layer" traffic on their flights. The highest prices are charged to those over whom the airline has market power or those who are thought to value schedule convenience and other "premium" product features the most. At certain times of the day or week (Friday afternoon, for example) planes can be filled in many markets with such travelers. At other times of the day or week, however, the airline will have seats left over to sell at lower prices. It does so through an elaborate system of multiple fares and restrictive seat allocations. *See infra* Part IV-G.

airline was in fact available and suitable for the employee's travel plans can be very difficult and also intrusive in a way that is costly to morale.[180] Obtaining a larger share of high yield traffic can provide a large incumbent with a revenue advantage that offsets a new entrant's cost advantages. In addition, it allows the firm to match a new entrant's prices on a discriminatory basis, thus reducing the cost of waiting out the new firm. Finally, it allows easier development of new spokes to a hub, by allowing profitable operation with fewer passengers.

The frequent flyer program presents a problem for even a large national airline attempting to start service on a route between cities where it does not already have a major "presence" and hence an inventory of frequent flyer program members. It means that entry at another airline's hub will ordinarily only be attempted by an airline extending service from its own hub. For a new entrant operating on a scale smaller than the incumbent, the frequent flyer program is a major obstacle rather than a mere marketing detail.

F. *Travel Agents and Incentive Commissions*

Deregulation has enhanced the role of the travel agent. In the years prior to deregulation there was considerable speculation over the future role of travel agents and their commissions. Travel agents issue tickets on behalf of airlines. They are compensated through commissions based on the gross value of the tickets they sell. Before deregulation, the CAB regulated the commission rate at which travel agents were compensated and made it illegal to rebate such commissions to customers. This regulation served to eliminate competition among airlines for travel agent services, in return for which the travel agents got the benefit of the CAB's services as a referee in their continuing tug of war with airlines about the level of commissions. The CAB regime also protected small travel agents from big ones. The regulated commission rate served as a minimum and was set at a level which allowed small agents to stay in business. The uniform rate also functioned as a maximum, preventing airlines from paying some travel agents more than others, and the anti-rebating provisions prevented large agencies from competing with small ones by passing some of their commissions along to customers.

The CAB also supervised travel agent accreditation, allowing the airline trade association (Air Transport Association or ATA) to select the agents with whom they would deal. In this way, the airlines could protect themselves from travel agents who might allow ticket stock to be stolen, or who might collect fares and abscond with them, leaving tickets in the hands of the public with no corresponding payments in the hands of the airlines. As the price for travel agent political cooperation in these arrangements, the ATA limited entry into the travel agent business to a greater extent than was probably necessary for security purposes, thus creating some value in a travel agent franchise.

---

[180] Of course, some of the cost in morale comes from the fact that the monitoring makes it harder for the agent to exploit the principal!

The travel agent market place that the combination of airline and agency regulation created was a very orderly one. Regulated fares were simple and easy for agents to deal with, so no travel agent could attract business through superior assistance with fare search. Since only one or two airlines served most routes and there was little likelihood of further entry,[181] and since the CAB regulated prices, airlines behaved as duopolists and oligopolists in soliciting travel agent preferences, offering as their principal inducements sales visits, receptions, brochures, aircraft models, and assistance finding seats during peak travel periods. Travel agents functioned largely as impartial and universal ticket outlets. They combatted indivisibilities by providing many more locations for purchase of tickets than airlines could afford to provide in single-airline sales offices. In large cities, travel agents competed with airline sales offices by providing tickets on many airlines in one place, credit and delivery services, and other services the airlines couldn't or didn't provide. Location selection, a minimum of cost control, and customer relations were the skills necessary to succeed in the business. As in any business with minimum rates set at levels designed to protect small producers, small and independently-owned locations proliferated.

Deregulation changed the rules and the marketplace. In the early stages of deregulation, commission rates were deregulated,[182] the "exclusivity" rules requiring ATA airlines and travel agents to deal only with each other were eliminated,[183] entry into the agency business was restructured, and the anti-rebating rules were scrapped. An orderly marketplace with few airlines and regulated fares blossomed (or exploded, depending on one's point of view) into a confused bazaar of new entrant airlines and the complex fare structure discussed above. Agencies were free to engage in price competition for clients through rebates, so efficiencies of scale on both the buying and selling sides of the market could be reflected in rates.

---

[181] There was *no* likelihood of sudden entry, since CAB route cases took years to complete. *See* REPORT OF THE CIVIL AERONAUTICS BOARD ADVISORY COMMITTEE ON PROCEDURAL REFORM (1975).

[182] The section regulating commissions for sales of air transportation, 14 C.F.R. § 253 (1977), was removed from the Code of Federal Regulations in 1980. *See* 45 Fed. Reg. 48,600 (1980).

[183] COMPETITIVE MARKETING, *supra* note 97.

Airlines were free to use outlets other than travel agents to distribute tickets, and experimented with everything from event ticket brokers to the United States Postal Service.

Much industry soul-searching about the future of the travel agent industry ensued. If airlines were free to deal with the public directly through other entities, would they abandon agents for electronic ticket delivery, or for department stores and banks? Would agents become dealers of one or a few airlines to the exclusion of others? If customers could deal with agents located on or near airports, would they stop dealing directly with airlines? Would any agencies be left? Would there be consolidation in the travel agency business of the sort which has taken place in the airline business? What function did travel agents perform anyway?

The answer that emerged was a bit surprising. Unlike the past, where travel agents in an orderly marketplace served principally as ticket vendors, the confused marketplace of deregulation allowed agents to sell information to customers. Deregulation *increased* the value to consumers of having an expert search for them, since it was more likely that a good agent could find a new airline service or a fare that the customer couldn't find herself. It also created new profit opportunities for travel agents, because it was very costly for customers to monitor the search process[184] and agents were compensated according to the value of the ticket, so that the more expensive the ticket sold, the higher the commission. In effect, this system rewarded an agent skilled enough and willing enough to find low fares or new-entrant airlines so that the customer could not detect shirking and would not take her business elsewhere, yet not so conscientious in doing so that tickets would be sold at the lowest possible prices, thus minimizing commissions.

Both agents and airlines quickly perceived the possibilities in this system. If search costs were significant for the customer and the agency could shirk in dealing with the traveler, airlines could earn incremental revenue by sharing with the agency the value of business the travel agency directed to it. Obviously, this possibility did not exist for all traffic. If a customer was tied to an airline by product loyalty, a frequent flyer program or an enforced company policy regarding airline and fare selection,[185] the agency could do little to redirect the customer's business and the airline would wish to pay only the normal commission for such tickets. The system rewarded airlines that were particularly adept at paying high incentive commissions[186] for business that was truly incremental and successfully distinguishing such business from business that would have come to the airline anyway. This required a highly developed capability for monitoring the total market, so as to deal with the principal-agent problems inherent in the airline-travel agent relationship.[187] This need for monitoring dramatically rewards airlines which can induce travel agencies to use CRSs controlled by the airline, an aspect of deregulated airline marketing we will explore in Part IV G *infra*.

---

[184] Doing so would negate the value of using the agent in the first place.

[185] Once airlines became sophisticated about the use of the complex fare structure and the frequent flyer program to counteract new-entrant pricing, the national brand airlines matched new-entrant pricing for most price-sensitive travelers, leaving the travel agent with some power to redirect the price-sensitive traveler. For the important high-yield traveler, the power of the frequent flyer program reduced somewhat the travel agent's power to steer business to an airline other than the ones in which the traveler was accumulating miles.

Just as frequent flyer programs can introduce economies of scope and scale into the reward structure faced by travelers (agents) choosing their travel at the expense of the employer/client (principal), so can incentive commission programs introduce the same sorts of economies into the reward structure of travel agents (agent) choosing routings and fares at the expense of their customers (principals). It is far less costly for a travel agent to participate in an incentive program operated by the airline offering the most service from its city (perhaps because it has a hub there) than it is to search among that airline's route-by-route competitors for an equally rewarding combination of incentive programs. An airline with a large presence at a city can arrange its incentives so that extra commissions earned by attracting traffic on particular routes can be applied to traffic on other routes. When incentives are arranged this way, the more routes an airline serves from a city and the more flights it has, the more rewarding travel agent participation in an incentive program can be. When these programs influence ticket sales, they introduce economies of scope and scale into deregulated airline markets.[188]

As the airline population has declined and route systems have reorganized around hubs, the travel agency system's value to the customer has become based on the complexity of the fare structure, although smaller travel agencies whose perceptions are rooted in the past tend to see this complexity as a cause of increased search and ticket issuing costs.[189] Deregulation has tended to reward large travel agents who can advertise their information processing capability to customers, take maximum advantage of incentive commissions, and achieve economies of scale which permit them to offer rebates.[190] As multiple location travel agents have expanded, they have also benefitted somewhat from information (advertising) economies of scale and scope in reaching customers.

---

[186] Incentive commissions, or "overrides," are commissions above the base level paid to travel agents on the basis of volume, market share, or special promotions ("book ten clients on our new service to Florida, and we'll give you an extra commission, or a free ticket you can sell, or a premium").

[187] Curiously enough, the system examined here generates principal-agent problems at *three* levels: first, between customer and travel agent; second, between the airline and the travel agent who is supposed to be making an extra effort to sell its services in return for incentive commissions; and third, between the travel agency and the individual travel agent who does not own the agency and who, without supervision or special incentives, will influence travelers to buy tickets on those airlines willing to reward him directly with merchandise, amusing sales visits, free trips, etc., rather than the airline which best rewards the agency. Airlines attempt to assist agencies signing incentive contracts with them by devising ways to monitor or reward individual agents so that this problem is minimized.

[188] While it might be thought that smaller airlines could combat this problem by combining their travel agent incentive programs, transaction costs make this extremely difficult. *See supra* note 145.

G. *Computer Reservation Systems*

The role of information management in the deregulated airline market must now be apparent. Some conduit is needed to give customers access to the enormously complicated inventory from which they make their travel choices. Customers wish to choose from seats available in many thousands of city-pair markets sold in a mind-boggling number of combinations on thousands of connecting flights every day for up to a year in advance. Each seat has associated with it several to many fare possibilities which vary depending on the rest of the customer's itinerary and other customer characteristics designed to facilitate segmentation. This information was once made available in a telephone book-sized document detailing for travel agents and customers the schedules and fares available. But schedules now change quickly and connecting possibilities have mushroomed, making such a document difficult to use even for trip planning. The fares available are so numerous and change so quickly that they can no longer even be listed; the flights on which they are available and the quantities of seats on each flight to which they apply are changed daily. Electronic assistance in making a frequently updated data base available to customers through travel agents is a necessity in this environment.

The airlines themselves need to manage these complex, layered inventories of seats available to different segments of the market on different terms. The more sophisticated airlines track the purchase habits of their customers, especially their most frequent flyers, so they can obtain information which can be used to segment markets, in part by fashioning awards which will present customers with the scope and scale incentives necessary to ensure loyalty. While they use information to monitor the effects of their efforts to exploit principal-agent conflicts between travelers and their employers, airlines also need to monitor their efforts to induce travel agents, through incentive commission programs, to exploit the divergences between their own interests and those of their customer principals. These incentive commission efforts create yet another set of principal-agent relationships, this time between airlines wishing to reward only incremental business diverted from competitors by travel agents, and travel agents seeking extra commissions from business that would have been placed on that airline anyway, thereby reducing the risk to the agency of customer dissatisfaction. This conflict forces airlines to maintain the monitoring capability necessary to police their relationship with travel agents.

---

[189] Travel agents also, of course, provide valuable services related to ticket printing and delivery and credit, but these services are increasingly obtainable through other channels, such as ticket-by-mail and the use of credit cards. The "one-source" aspect of these activities is, of course, a significant information and transaction economy.

[190] Ironically, one service that travel agencies have offered to large customers is assistance in tracking employee travel selection behavior so as to reduce the cost to employers of frequent flyer principal-agent effects. In fact, some large travel agents offer software to help their customer firms reduce the costs of monitoring the decisions of their travelling employees. *See, e.g.*, Advertisement, "Announcing Air Planner Plus—A Thomas Cook Exclusive," *Frequent Flyer*, Apr. 1987, at 1.

CRSs are the key to meeting all these information needs. Airlines built such systems for internal use in the 1960's and 1970's, and enhanced them dramatically after deregulation to manage the much more complicated database arising from fare complexity and frequent route and schedule changes. These systems themselves exhibit economies of scale and scope,[191] and it became common for some airlines to sell the use of their internal systems to others, saving them the cost of developing systems of their own. Enough vendors of such services existed to make their supply to other airlines competitive and various hostage-taking devices were invented to deal with the relationship-specific commitments required. In this role, CRSs were production tools, rather than systems of demand enhancement; they presented few opportunities for exploitation of principal-agent relationships because employees of the customer airline generally did their own booking and inventory management using the system hardware and software provided by the vendor.

Interest in travel agent computerization initially centered on reducing the cost of issuing a ticket by automating the booking and ticket writing functions. At first this was seen as an information production and processing problem similar to the initial creation of in-house CRSs and the initial provision of computer services between airlines. There was much discussion of the possibility of an industry-wide "neutral" booking system through which all travel agents would have access to the inventory of all airlines on the same terms. Free-rider problems and uncertainties about the necessary degree of automation prevented this neutral system from

[191] Algorithms used to solve problems for one city-pair and date can easily be used for another city-pair. The schedule and seat inventory of a customer airline can be added to the host airline's computer as an extension of its own inventory, kept separate from its own inventory by an electronic partition, and can be managed more or less in the same way as the host airline's own inventory data base.

coming into being. By the late 1970's, with the growing complexity of the system, travel agents needed computer assistance simply to gain access to airline prices, schedules, and seat inventories, as did the airlines themselves. At the same time, the "new industrial organization" factors outlined above attracted attention from several of the largest airlines. As inventory complexity made obtaining schedule information, pricing, and booking more difficult, the possibility of influencing traveler choices by biasing the information provided to travel agents became evident. American, United, and TWA invested in systems which provided automation functions for travel agents, thus reducing their unit costs for booking and issuing tickets. These systems were deliberately biased in their presentation of schedules and fares so it would be much easier for a travel agent to find and use services of the system-owning airline rather than those of its competitors.

While systems independent of individual airlines could certainly have answered the needs of travel agents, and at least one such system was offered,[192] airline-owned systems quickly dominated the industry. An independently-owned system had only two sources of revenue: It could charge airlines to offer their inventory to the public, and it could charge travel agents using the service. But airlines would not pay for inclusion unless the system had already achieved market penetration with travel agents; to do that would have required a substantial cash investment. An airline-owned system, on the other hand, had a third source of revenue: the extra sales coming from customers directed to the airline *not* by selection of its offering after neutral comparison in the marketplace, but instead by travel agents choosing from biased schedule and fare information presented on the computer screen, and biased further in their recommendations by commission incentive programs efficiently monitored by the very same computer on which the bookings were made. This source of revenue impelled airlines to offer their CRSs to travel agents at little or no cost in return for a long-term agency commitment. A travel agency would choose this low priced alternative because it could get customers facing high monitoring costs in a complex marketplace to accept biased choice unknowingly, could make extra revenue from these biased choices through participation in special incentive commission programs offered only to CRS subscribers, and could overcome bias by further search effort where customers insisted on other choices.

In short, airline-owned systems distorted the travel agency's incentives through a kind of information externality: The agency enjoyed the benefits of automation at prices deliberately kept low by the system provider, in return for which the agency passed the costs of more restricted choice on to its customers. As deregulation made the market environment more complex, both the benefits to the agency of automation and the costs to the traveler of monitoring her travel agent's choices rose. Airline-provided CRSs became enormously popular with travel agents and with the three airlines whose systems were most widely used.

---

[192] The non-airline-owned system was called MARS-plus.

As the market became more complex and the role of information costs became clearer, the usefulness of CRSs to their airline owners grew. Placing its CRS in a travel agency for the agency's use in booking all its business gave significant information advantages to the airline owning the CRS. These advantages fell into two principal categories: market intelligence and the ability to manipulate market signals on the one hand and, on the other, the airline's ability to monitor its own agents in exploiting their relationships with other principals.

An airline which controls the system on which travel agents make bookings on itself and its competitors gains market intelligence because it receives real-time information about market preferences and the success of marketing initiatives. An airline without access to the information generated by such a system knows only the travel patterns of those who buy its tickets. Older market data is available from the Department of Transportation, but this data is deliberately delayed by nine months to minimize the disclosure of competitively sensitive—that is, immediately useful—information. Alternatively, the airline can have employees count passengers boarding or deplaning at rivals' airport gates, but such observation is expensive and doesn't provide any of the most valuable information. "Counting" flights at a hub does not reveal the true origins and destinations of those boarding a plane, nor does counting at a spoke. Class of service cannot be observed this way, nor can price and discount categories for tickets. In an era of hub and spoke route systems and complex fare structures, it is extremely difficult to estimate the revenue a rival's flights generate by looking at passenger counts. For the same reasons, it is difficult to discern the success or failure of a fare initiative, advertising program, or service change without better data than can be obtained by crude observation.

In contrast, an airline whose CRS is used by travel agents has access to a very accurate picture of both its own and its rivals' business patterns. Through the CRS an airline can track the effect of price changes, see roughly how much of a rival's seat inventory is assigned to a given discount fare classification, measure how much full-fare business it attracts compared to rivals, and track changes in shares of city-pair traffic flows and of market demand subsegments. It can even see how loyal its own frequent flyers are. A CRS owner can then use this information to distort market signals to its rivals, leading them to make incorrect decisions. When a CRS owner sees travel agents making bookings on a rival airline's flights, it can intervene through targeted secret incentive programs in an attempt to switch business. By responding selectively, it can temporarily distort signals the market sends to competitors, in order to persuade the rival to abandon fares, schedules, or even routes where, absent these secret interventions, its offerings would be preferred by customers.

This power of observation assists the CRS owner in its own efforts to distort principal-agent relationships. In a sense, the computer system gives its owner a technological advantage over rival principals in monitoring the behavior of agents for whose allegiance they compete. A travel agent has two sets of principals: the travelers who use his services and the airlines whose tickets he sells. Incentive commission programs attempt to induce the agent to breach his responsibility to travelers in favor of a particular airline. Without a CRS on which an agent makes all his bookings, it is difficult for an airline which has signed an incentive commission agreement with an agent to know what effect the program has had or even whether the agent is complying with its terms. In an industry of considerable fluctuation and uncertainty, it is easy for a travel agent to claim falsely that disappointing results should be attributed to slow business at that location, or that the disappointing revenue he gives the airline in question represents the required percentage of his total bookings. In fact, it is not difficult for an agency to find a way to participate in the incentive programs of several competing rivals, making it an agent for multiple principals, all of whom it is shirking. Data from CRSs obviously facilitate monitoring by airlines. If a travel agency makes all its bookings on an airline's system, rewards can be constructed based on actual performance, and "cheating" by the agent is difficult indeed. An absence of cheating presents competitors with fewer opportunities to contest markets.

Both the market intelligence and the monitoring capability provided by CRSs placed in travel agencies depend on the agency making all its bookings, including those on rival airlines, on one airline's system. As a result, it should come as no surprise that these systems are placed in travel agencies under contracts whose terms strongly reward exclusivity of use. If an airline owning a system hopes to make much of its revenue from the system in the form of increased profits on its own airline, it can offer the system to travel agents at very low prices. Since installing the system in an agency is expensive and involves substantial non-recoverable costs in equipment and training, the airline will insist on a commitment from the agency to use the system on a long-term basis. Before they were made unlawful by the Department of Transportation's CRS rulemaking,[193] exclusivity provisions were common, justified by the need of the CRS supplier to ensure that this expensive investment would in fact be used by the agency. These provisions can be explained in Williamson's terms as a form of hostage-like commitment on the part of the agency to induce the airline to supply expensive transaction-specific facilities which are only valuable if used. However, they also are occasioned by a compensation system for the CRS-owning airline that relies on the value of information and principal-agent distortions for recovering the airline's investment, rather than on fees to the travel agency for the valuable services provided to it by the system.

Many of these effects were addressed as part of a rulemaking undertaken by the CAB[194] in response to pressure from the Department of Justice and airlines other than United, American, and TWA, which then owned the largest travel agent CRS systems. Complaints about the uses to which these systems have been put are also the subject of a pending private antitrust action.[195] The rulemaking reduced or eliminated some of the more obvious distortions of marketplace information and impediments to contestability by ruling out the more blatant forms of screen bias in the presentations of schedules and fares, eliminating the discriminatory provision of services such as automated boarding passes, eliminating explicitly forced exclusivity, and mandating access by other airlines to marketing "reports" generated from CRS data.[196]

But the rulemaking by no means eliminated the preferential access to information and greatly enhanced ease of monitoring that CRSs provide. CRS owners still have advantages both from immediacy of availability and from the difficulty to non-owners of gaining access to information not in reports.[197] Notwithstanding the rulemaking, airlines still struggle to induce travel agents to use their CRSs, even paying them to switch from other systems. This behavior strongly suggests that substantial rents accrue to airlines owning CRSs when agencies use their systems. The existence of these rents is also deducible from the failure of the only non-airline-owned travel agency computer system (MARS-plus) to penetrate the market. Among its difficulties has been the need to rely on payments from travel agents, rather than rents generated for airline operations, to fund the system.

---

[193] 14 C.F.R. § 255.6 (1986).

[194] 49 Fed. Reg. 32,540 (1984) (codified at 14 C.F.R. § 255 (1986)).

[195] *In re* Air Passenger Computer Reservation Systems Antitrust Litigation, MDL-667 (C.D. Cal. consolidated Jan. 31, 1986).

[196] For descriptions of the abusive uses of CRSs, see Republic Airlines, Inc. v. United Airlines, Inc., 796 F.2d 526 (D.C. Cir. 1986); United Airlines v. Civil Aeronautics Bd., 766 F.2d 1107, 1115 (7th Cir. 1985) (upholding CRS regulations); Carrier-Owned Computer Reservation Systems, 49 Fed. Reg. 32,540, 32,562-4 (1984) (codified at 14 C.F.R. pt. 255 (1986)). *See also* Carter, *A Different Air War*, FORTUNE, Feb. 18, 1985, at 120 (CRSs compete unfairly).

[197] CRS owners supply other airlines with raw data tapes on a slightly delayed basis. Aside from the delay, the receiving airline has to duplicate software already in existence in order to extract information from the raw data tapes. This cost is a constant, and the CRS owners do not supply the software. Extracting the data is thus costly to any airline, but to smaller airlines it represents the handicap of yet another information economy of scale.

Particular airlines' CRSs seem to dominate the geographic areas centered on hubs dominated by the airlines that own them. This occurs because CRSs aid in the exploitation of economies of scale and scope in information and in shaping principal-agent relationships, and the principal compensation received by the owning airline is the rents generated on the associated airline. Geographic computer domination is worth more to an airline that has many flights originating in that region for which the computer system can enhance revenue. And the complementary character of the economies of scope and scale involved in hub and spoke systems, frequent flyer programs, and travel agent incentive commission programs finds parallels in and is enhanced by the economic characteristics of these systems.

H. *Control of Slots and Facilities*

Among the most remarked-upon[198] impediments to contestability in the deregulated airline industry has been the "shortage" of terminal facilities, especially gate space, at a number of important airports and the difficulty of obtaining landing slots at the four airports subject to the Federal Aviation Administration's High Density Airport rule.[199] It seems intuitively obvious that airlines serving airports where these factors of production are in particularly short supply enjoy some protection from entry and earn economic rents.

Since it is a commonplace that *any* economic resource is scarce, scarcity alone cannot be an impediment to contestability. In fact, the principal contribution which contestability theory makes to competition theory is its demonstration that an efficient equilibrium can be achieved even where technology constrains market structure so that only one firm may serve the

---

[198] *See* Call & Keeler, *supra* note 7, at 221, 223 (arguing that deregulation will not necessarily lower fares, due to product differentiation); E. BAILEY & J. WILLIAMS, *supra* note 14, at 11 (arguing that despite deregulation, larger trunks continue to have stable rents).

[199] "Slots" are time periods during which airlines have landing or takeoff rights. Prior to deregulation the CAB approved agreements allowing carriers in certain congested airports to form scheduling committees to allocate among themselves limited slots. The certificated carrier approval was first granted in CAB Order 68-12-11, Dec. 3, 1968, and the commuter carrier in CAB Order 69-2-52, Feb. 12, 1969. Access to ground facilities and slots are currently controlled by airport authorities. This control has been unsuccessfully challenged. *See* Pacific Southwest Airlines v. County of Orange, CA-81-3248 (C.D.Cal.). Local control is subject to FAA control of airspace. *See* High Density Traffic Airports, 14 C.F.R. §§ 93.121-.133 (1986). *See also* E. BAILEY, D. GRAHAM & D. KAPLAN, *supra* note 7, at 180-84, 190-93.

Paradoxically, this realization may help an airline attempting new entry in the "post-shakeout" era of airline deregulation. The welter of new entries, route system realignments, and fare experimentation that has characterized the post-deregulation era has made it very expensive for a new entrant to make its presence known. For the first few years following the dramatic reversal of forty years of government-suppressed competition, new entry was intensely interesting to the media. New entrants used such tactics as mass giveaways of tickets at impossibly low introductory prices to maximize their attractiveness to the media and the value of media attention to them. Consequently, the first new entrants to spring up around the country received a great deal of free publicity and consumer trial. This attention, along with the inexperience of incumbents in dealing with new entry, reinforced the mistaken impression of many that it was the incumbents, not the new entrants, whose survival was in doubt.

After this early period, marketplace confusion and the growing sophistication of holdover airlines in dealing with upstart competition created a climate in which information burdens became considerably greater, while costs of operating long enough to overcome them increased as well. We are now emerging from this period and its concomitant industry consolidation. The recent considerable reduction in the number of competing brands, along with the media attention that has been given the consolidation phase, may reduce the information burden of a future new entrant by once again making its appearance the subject of a great deal of public and media attention. But at this point, it is still much more likely that any new entry into the industry will come from firms that find and exploit production, product, and information niches.

V. Policy Implications

What should government response be to the fact that deregulated airline markets apparently exhibit substantial impediments to contestability? Does this daunting litany of "market imperfections" mean that deregulation is a policy failure? An unreflective observer, especially one whose interests had not been advanced by deregulation, might be tempted by the following line of reasoning: (1) Airline deregulation was justified by the academic conclusion that airline markets were nearly perfectly contestable; (2) Experience with deregulated markets suggests that impediments to contestability are far more significant than any academic observer predicted; (3) Therefore, airline deregulation was a mistake and the industry should be reregulated. This syllogism may seem plausible, but it addresses the wrong question—"Are deregulated airline markets as contestable as predicted?"—and thus reaches the wrong answer.

While deregulation was indeed promoted because it was believed that perfectly contestable markets would result, the contestable markets themselves were not the ultimate goal; they were *instruments* expected to produce public benefits. These public benefits, not the economic instruments devised to achieve them, are the ultimate objectives of airline regulatory policy.[225] Even if deregulated airline markets are not as contestable as predicted, that only begins, rather than ends, the inquiry as to whether deregulation has been good public policy and whether reregulation of some kind would be desirable.

What *is* the right question? In the abstract, it asks: "Do deregulated imperfect airline markets work better than imperfectly regulated ones?" Put concretely, it becomes: "Do we know of any government interventions which would make airline markets work better for the public than they do under current arrangements?" Notably, the word "contestability" does not appear in this question, although it may well be part of the answer. Contestable markets are desirable because they cheaply, effectively, and continuously create incentives that force producers to produce efficiently and to satisfy consumers. The principal goal of any government intervention into airline markets ought to be the same.[226]

To spare the reader suspense, let me here state my conclusions about policy changes. Many deregulated city-pair markets, especially those in which the principal service is one-stop over competing hubs, *are* workably contestable and are thus achieving public objectives. Their performance is very unlikely to be improved by intervention. These markets are producing in great quantity many of the benefits forecast by analysts who favored airline deregulation. They are producing as well many others which were not predicted, such as easily identified online one-stop service to virtually any point in the country. In many other markets, and especially at hubs, airline deregulation has yielded substantial benefits *despite*, and sometimes *because of*, the impediments to contestability we have examined. Here, too, the present state of the regulatory art does not suggest any general interventions that would improve the situation. In summary, then, airline deregulation has undoubtedly proven beneficial and ought not to be undone.[227]

---

[225] Of course, economic institutions like markets or regulatory schemes can have characteristics which are thought to be intrinsically desirable as a matter of political philosophy and so can be created or promoted because they are thought to be fair processes for resolving competing claims on resources. *See generally* M. FRIEDMAN, CAPITALISM AND FREEDOM (1961). Whether this represents instrumental or ultimate justification is well beyond the scope of this Article. It is clear that whatever *public* considerations—as distinct from private gains sought to be captured through public intervention—motivated the political economic arrangements governing airline competition were focused on transportation benefits, rather than the construction of a just state. Private gains that might have been sought through airline deregulation or that might be sought through reregulation are not the subject of this Article. *See* Levine, *supra* note 1, at 180.

[226] We know from experience with airline regulation, farm price supports, oil and natural gas price regulation, and many other programs that additional public purposes, such as achieving whatever social benefits are thought to flow from the availability of transportation services to small communities, ought to be pursued specifically and cost-effectively, rather than through interference with efficient production arrangements.

A few impediments to contestability could, however, be alleviated by government intervention. The most promising strategy probably would be to take actions designed to reduce the ease with which agents can act in ways at variance with the interests of their principals. The main justification for such intervention would not be to regulate or improve the relationship between principal and agent, but rather to limit the degree to which principal-agent problems act as a filter between airlines and those who ultimately pay for tickets. This should improve the ability of airlines, especially smaller ones, to compete using strategies (like lower prices for business travelers) which do not exhibit economies of scope and scale. Probably the most important of these interventions would be the forced divestiture of travel agency CRSs from airline ownership.

I will suggest a few other specific and limited interventions that might also be beneficial. But many of the major impediments to contestability described here stem from forces that produce real economic benefits to the public. To eliminate them in the name of enhancing "contestability" would do the public more harm than good. And another important impediment to contestability—the profitability of predatory practices—is a disease common to many markets in which information is important, and for which there is no known treatment with acceptable side effects.

Several important impediments to contestability identified and analyzed in Part IV arise because information is costly and is especially important to consumers in dealing with a complicated network service like airline transportation. Further, information has unusual characteristics which have been recognized at least since the invention of the public patent, trademark, and copyright concepts. The development of hub and spoke systems operated by large carriers, and the consolidations through which many of these large systems have been assembled, represent responses both to the consumers' need for market information and to the economies of scope and scale in producing the information. This market information includes not only the presence of an airline in a city-pair market, but reputation and service information which is subtle and difficult for individuals to accumulate and assimilate. Once assimilated, this information is necessitating complete reregulation to compensate for the resulting distortions of competition. Holding down the price of steak does not benefit hamburger eaters.

---

[227] The most careful aggregate analysis available suggests that the public benefits of deregulation averaged six billion dollars per year (airlines benefitted by another $2.5 billion) through 1983. Since four billion dollars per year of those public benefits came from improved route structures and flight frequency, there is no reason to doubt that they have persisted, as the industry has continued to grow despite consolidation. *See* S. Morrison & C. Winston, *supra* note 7, at 11-52.

CRSs are in a different category from mergers. Their value to airline owners, as opposed to travel agencies or consumers, is principally a product of their ability to distort choices, either by distorting information or by facilitating the distortion of incentives through the exploitation of principal-agent effects involving travel agents. While it is easy to see why these systems are valuable as sources of information in a deregulated marketplace, that same usefulness makes it difficult to believe that travel agents would not demand them and firms supply them if airlines were not allowed to own them. Explicit prices for their rentals to travel agents would go up, but not because the true cost of providing the service would be affected. Rather, this price rise would represent the lower bound of the amount of additional revenue which distorted choice now provides the airlines owning the systems over and above the revenue that they would be able to earn in an open marketplace. This revenue may be considered the minimum measure of the welfare loss that these systems impose on customers.

The advantages that CRS systems confer on their vendors are very subtle and hard to control. The CAB, and now the DOT, have already attempted to regulate these systems.[231] While the regulations may have improved the displays, it would take far more intrusive regulation to make the systems unbiased sources of information and to avoid their use to distort passenger choices. To use just one example, interest has recently resurged in the contracts under which the systems are provided to travel agents. These contracts allegedly contain onerous obstacles to switching from one system to another, including, among other things, liquidated damages clauses obligating a cancelling agency to pay the vendor eighty percent of the fees the vendor might have expected to receive over the remaining life of the contract.[232] A student of Professor Williamson's work[233] might wonder whether the liquidated damage clause represents the creation of a legitimate "hostage" to protect a firm-specific investment not recovered in the initial installation fee. A skeptic might point out that it is not the much smaller reliance interest (installation cost) which is used in these contracts as the measure of damages, but rather the very large expectation interest (fees foregone).

---

[231] *See* Carrier-Owned Reservation Systems, 14 C.F.R. §§ 255, 256 (1986).

[232] Renton & Gaudin, *Reserving Judgment*, AIRLINE BUSINESS, Mar. 1987, at 18, 19.

[233] O. WILLIAMSON, *supra* note 115.

The important point is not to resolve that dispute, but the very fact that resolving it and many other subtle and complex issues like it would be the regulatory task facing an agency responsible for removing inefficiencies created by these systems. A proposed bill involving fee arbitrations,[234] a major lawsuit opening the possibility of regulation by antitrust settlement,[235] and pressure for further DOT regulation all contain enormous potential for government mischief. A good case could be made for the proposition that the method of resolving the issue with the least potential for damage through misplaced government intervention is simply to require divestiture of the CRSs by the airlines and accept whatever level of contestability is exhibited by the divested market, reassured by the knowledge that whatever distortions still exist will not taint the operation of the far larger airline market. Requiring airlines to divest themselves of CRSs would also impede somewhat their ability to monitor travel agent incentive programs and, to a much lesser extent, frequent flyer programs.

In an ideal regulatory world, programs such as these would be limited, modified or eliminated in order to minimize the divergence of interest between principal and agent, since this divergence can be and is exploited in ways that impede contestability. In a world in which it is difficult to eliminate rents produced by impediments to contestability without losing the efficiency gains simultaneously created by those same practices, government should proceed very cautiously. But, it is difficult to defend as efficient those practices which reward undisclosed distortion of choices by agents at the externalized expense of principals. The principal risk is intervening to control them in a way that does more harm than good. Regulating these programs in detail would entangle the regulatory agency in a morass of complicated marketing decisions about which it possesses little information (for example, real time knowledge of unsold seat inventories which might be worth selling on concessionary terms) and less expertise. Worse, many of the most effective regulatory devices, such as requiring the disclosure by airlines to employers of employees' frequent flyer accounts, would entail invasions of privacy which most of us would find unacceptable as a means of achieving more contestable airline markets.

Paying travel agents for their sales efforts is legal, and ought to remain so. Giving a discount to regular customers is an unexceptionable (except to the few devotees of the Robinson-Patman Act) practice. Giving the discount in the form of free travel is a particularly efficient way to reward these customers because it uses as payment seats which have a high probability of going unsold (in part because of limitations on devising discriminatory fares to fill them), creating a medium of reward which has high value to customers at low cost to airlines. *Undisclosed* payments which, unknown to the traveler, affect the travel agent's advice to her, and rewards to travelers (concealed from their employers by airline policy) which affect their choices of airlines, fares and routings in ways which raise the costs of trips to those paying for the tickets or the traveler's time but are too costly to monitor represent a problem which can be addressed at an acceptable cost.

---

[234] H.R. 1217, 100th Cong., 1st Sess., 133 CONG. REC. H791 (1987).

[235] *In re* Air Passenger Computer Reservation Systems Antitrust Litigation, MDL-667 (C.D. Cal. consolidated Jan. 31, 1986).

Given the size of the incentive to firms to control their travel costs, it might seem likely that the market should reward efforts to reduce through technology the cost of monitoring the travel plans of employees.[236] We certainly shouldn't rule out the possibility for progress in this respect, but the problem is likely to remain as long as there are frequent flyer programs. The principal obstacle to the use of technology to improve monitoring is the difficulty of specifying rules for and monitoring choices in response to uncertainties (such as the need to change travel plans because the location, time, or duration of a meeting changes) which are resolved only after the initial ticket has been booked. Eliminating employee discretion in such circumstances is nearly impossible, and frequent flyer programs make the rewards for "opportunistic" behavior high. And, as mentioned above, concern for personal privacy would seem to suggest that requiring airlines to report their frequent flyer accounts to their employers would be objectionable on non-economic grounds.

It is difficult to be sanguine about the efficacy of legislating honesty in an imperfect world, even when the legislation's purpose is as worthy as enhancing the efficiency of deregulated airline markets. And it is difficult to claim that the two measures proposed below will have a great deal of effect. Nevertheless, there are two interventions designed to limit the rewards to agents of misleading principals which would cost very little and might do some good.

First, travel agents should be required to disclose to ticket purchasers the existence of commission overrides on tickets sold. This measure is a bit more complicated than it may sound. Some incentives, particularly those monitored by CRSs, are paid at a variable rate depending on performance, so the agent does not know at the time the ticket is delivered to the customer just how large the extra commission will be. An acceptable form of disclosure might somehow alert the customer to the existence of the program and require disclosure on demand of the terms of current incentive programs in effect. If customers don't care to inquire further, little purpose would seem to be served by forcing the information on them. However, the need to disclose the existence of a program in use by an airline on which a traveler is booked might limit the degree to which the programs could subvert the choices of customers who actually care. Disclosure to customers, and hence to competitors, might also reduce the attractiveness of overrides as a competitive tool and direct selling effort toward those actually paying for the tickets.

---

[236] *See supra* note 190.

Second, travelers who receive frequent flyer benefits on tickets they did not pay for should be required to report the bonuses as a taxable benefit of employment. This proposal comports with standard tax policy, and would limit somewhat the agent's benefit from choosing flights on the basis of frequent flyer programs. Again, certain complications will arise, including the difficulty of valuing a benefit which is limited in the periods during which it can be used and has a value which depends on the destination chosen and the fare structure in effect. And the impact on the agent's choice would take place only at the margin, leaving in place much of the agent's incentive to choose airlines at the principal's expense based on considerations other than price and schedule.

The fact that predatory tactics appear to be feasible, and perhaps even common, in the deregulated industry may seem to require a response, particularly since predation seems to act as an important impediment to entry by new or relatively small firms. Of course, many of the difficulties experienced by smaller new entrant airlines in competing with larger ones flow from the information and network advantages which accrue to consumers as a result of the forces which have been the principal subject of this Article. But there *are* predatory tactics which go beyond merely using real marketplace advantages. Regrettably, no response to them seems available which will do more good than harm, other than perhaps the use of Section 2 of the Sherman Act[237] for the most blatant "smoking gun" cases. The difficulties of devising a method for identifying and remedying predation in any industry are legendary among economists, but they are magnified almost beyond imagining in an airline hub, in which virtually all costs are joint and virtually all prices in some sense arbitrary.

To deal with predatory pricing in an airline hub and spoke system with flexible pricing, the regulator must be able to answer at least the following questions: What is the short-run variable cost of a seat between two cities receiving connecting service over a hub, when the two spokes involved provide service to literally hundreds of city-pairs? For that matter, what is the short-run cost of a seat on either spoke, when the other

---

[237] Sherman Antitrust Act, 15 U.S.C. § 2 (1982). Section 2 makes it illegal to acquire monopoly power by willful means. Coordination with outside parties is not required to produce a violation.

Senator METZENBAUM. Thank you, Mr. Levine.

Mr. Levine, let us assume that Congress should see fit or that the DOT should see fit to require divestiture. What assurance do we have that there would then be an operable system?

Mr. LEVINE. The services provided by these systems are simply too valuable to disappear. It is not possible to do business as a travel agent or as an airline in the deregulated environment without an information management system like a CRS.

And divestiture is technically practical. These systems can be operated on a stand-alone basis. The functions they provide for airlines who own them and integrate them in their own management can be provided just as computer-owning airlines now provide computer services to those which do not own computers.

Senator METZENBAUM. But you could not have a situation where there was no system.

Mr. LEVINE. I think that is simply impossible. It just would not happen.

Senator METZENBAUM. You just think some business person would go into the business.

Mr. LEVINE. Yes. I think that many companies would be interested. These are very valuable businesses. I believe that those acquiring CRSs as part of divestiture will make substantial payments to the airlines selling the systems. I think we would probably end up with about three systems, with the third perhaps formed by combining the three smaller systems in the current environment.

Senator METZENBAUM. Isn't there only one system now that is not owned by an airline?

Mr. LEVINE. Well, there is no important non-airline owned system now. There is MARS PLUS, which has no impact on the market. Airlines which own CRS's get the benefit of business steered to them by these systems. In order to place these systems as widely as possible they undercharge travel agents for their use. It is impossible for someone who does not own an airline to compete.

Senator METZENBAUM. Mr. Magary, you complained most about the booking fee practices of the CRS vendors. What evidence do you have that booking fees greatly exceed costs, and what in your opinion is the best and most realistic solution to this problem?

Mr. MAGARY. Well, Mr. Chairman, with respect to evidence, first of all, as I indicated in my testimony, the CAB, using its own data, and DOJ data, showed that booking fees, which at that time were only 30 to 50 cents a booking, bore no reasonable relationship to costs. Now booking fees are far higher, close to the $2 range, and bear even less relationship to costs.

Secondly, a number of carriers, acting together, commissioned an independent study with an outside expert firm, Simat, Helliesen, and Eichner, in 1985, shortly after the imposition of the dramatically escalated booking fees. This study found that the cost per booking to United was about 66 cents, and the cost per booking to American was about 33 cents. At the same time as this study was taking place, they were charging other carriers approximately $180 per booking.

Senator METZENBAUM. Is that not part of the free enterprise system? Do they not have a right? They developed the system. Do they not have a right to charge what they want, and the fact that they developed it and it costs them 66 cents and they charge $1.85, is that not part of the competitive world in which we live?

Mr. **Magary**. Mr. Chairman, as I explained in my written testimony, this is not merely a matter of building a better mousetrap. The industry as a whole was on its way to developing an industry booking system prior to deregulation, and during the period prior to deregulation the CAB had, as a matter of policy, allowed American and United to enjoy a national system which other airlines did not enjoy. We did not start out with a level playing field, and at that time American and United seized upon the opportunity they had with the dominance the CAB had given them and proceeded to break away from the industry group, knowing that they could independently move forward to impose a duopoly on the rest of the industry.

Senator **Metzenbaum**. Would you make available to the committee a copy of that study you just mentioned?

Mr. **Magary**. I would be glad to.

Senator **Metzenbaum**. Mr. Beauvais, you say Congress should seriously consider divestiture as a remedy for competitive abuses in the airline owned CRS market. Perhaps it should, but Congress has ordered divestiture in only the rarest and most extreme circumstances. Before I favor divestiture, I would want to know that the new order would be better for competition and consumers than the old and, frankly, this Chair is more concerned probably about the position of the consumers and the impact on consumers than I am about the competitive aspects of any one airline vis-a-vis another airline. What assurances can you offer that the new order would be better than the present situation? You might also pick up the question that I asked Mr. Levine, and that is if you order divestiture, how do we know what would occur and that there may not even be an operable system?

Mr. **Beauvais**. Number one, these systems have evolved since deregulation and there has been plenty of time given to these systems to demonstrate that they are effective, particularly for the consumer, and the evidence is clear that they are not. The evidence is clear that the charges going back and forth between carrier-users are excessive, and the evidence is also clear that the consumer is not getting the best flight for the best price.

So, what we also see, after extensive studies, and the evidence is also clear, that these are highly profitable operations, extremely profitable operations, therefore it is easy to conclude that, as independent companies, these could be very successful. Independent companies driven by the technology that has been demonstrated to be feasible, independent companies that could then point the maximum thrust of their effort to the benefits of the consumer, it would recreate the objectivity of the travel agencies. The travel agency industry today is not objective, it is owned by the carrier vendors, and therefore it precludes them from being truly objective in serving their customers.

The spinoff and divestiture is a very easy thing to see, and I think that evidence on that could be easily gathered from the experts on Wall Street to demonstrate that these systems could be financed, and the carrier vendor developers could be more than adequately compensated. As a matter of fact, I read recently that by virtue of the various divestiture steps that ALEGIS is going through, they are considering a possible 50 percent sale in COVIA to an interested other carrier vendor for a sum of close to $500 million, and that is just for 50 percent, therefore I think it would be reasonable to conclude that that is a natural economic evolution.

The issue I think here is that in the free enterprise system what we have seen here is that, in order for it to work, we have to have a bona fide competitive atmosphere. Now, it is not working today in the CRS area because it is not a bona fide competitive atmosphere for the benefit of the consumer. You can create that by divestiture, by pointing the incentives of those companies to the technology that they can develop and pointing them away from what distorts the competitive balance in this industry, and that is carrier ownership and the biases that go with it, the override programs that go with it, and so forth.

Senator **Metzenbaum**. Mr. Beauvais, I am concerned. I know a little bit about your success in your business. You are a free enterprise advocate. I am an advocate and product of the free enterprise system, and I am concerned about the thrust of your comments.

I can understand the need to require these CRS systems to be available to all persons on an equal basis, not to provide any advantage to one airline over another, to make it possible for travel agents to shift from one CRS system to another. But I am trying to rack my brain—I just asked my staff how often Congress has ordered divestiture in the past—and I am having some difficulty with the concept of divestiture, as to whether I, as a U.S. Senator, ought to say to American or Northwest or United or American West or whatever, you have to get out of this part of the business.

I can see requiring a fair playing field, but I have great difficulty in seeing Congress coming along and saying somebody has to give up some particular business that they are in.

Mr. **Beauvais**. You have to have a reason, and I think when you look at this industry, you can easily conclude that there is a serious problem in this industry today, and Mr. Magary outlined that in articulating the number of airlines that no longer exist. Now, why are we having massive acquisitions? Why are we having the situation today where just three short years ago there were at least 15 airlines that were very good, solid, independent competitors which no longer exist? Why were these airlines at some point brought to a conclusion? They could not handle the competitive atmosphere that they were in.

Senator **Metzenbaum**. Are you saying that it all relates to the CRS?

Mr. **Beauvais**. That is one of the fundamental reasons why we have had massive consolidations, because the carriers conclude that if they put a flight in a market in direct competition with a CRS vendor owner, that they are facing a market share deficiency that precludes them from being successful. They have to have access to the people who write the transportation and they cannot. There is a very serious barrier to entry. There is a very serious antitrust issue at stake here, and there is a very serious problem that keeps the competitive balance in this industry from really producing what a free enterprise environment should be, and as——

Senator **Metzenbaum**. Has not American West grown, in spite of all of these things?

Mr. **Beauvais**. Yes, Senator. It is like scaling a cliff.

Senator **Metzenbaum**. Scaling a cliff?

Mr. **Beauvais**. Scaling a cliff.

Senator **Metzenbaum**. But as long as you get there, it is not too bad.

Senator **DeConcini**. You get bruised up a little on the way, is what you are saying?

Mr. **Beauvais**. That is true, and we need a few rules changes to make the game more interesting.

Senator **Metzenbaum**. But even though I have already indicated my concern about some of the practices, I am still having difficulty on the issue of divestiture.

Let me go over to Mr. Levine, because our time is rapidly running out. Mr. Levine, while the CRS rule requires equal access to CRS generated marketing data, some believe the vendors still enjoy enormous real time advantages and access, and that their systems enable them to engage in a form of commercial espionage. First of all, what does real time mean in layman's terms? And do you have any views or experience with respect to this problem?

Mr. **Levine**. What real time means in layman's parlance is that you can at will call up information on terminals that will tell you what is going on in the system, whereas other people often have to wait for marketing reports. I know that when I was chief executive of New York Air and trying, by the way, to provide your constituents in the Cleveland-New York market a pretty good service at what we thought was a reasonable price, we had enormous difficulties because any time a travel agent started producing business for us, he would be visited almost immediately by a United salesman. The reports I got from travel agents directly and from our own people were that those salesmen would say, "we see you have begun to book that new New York Air flight" or "begun to book that new New York Air fare. Remember all United has done for you and all the things you'll need us for in the future." The important impression conveyed to the Apollo agent was that big brother United was watching, was watching every move.

Senator **Metzenbaum**. New York Air closed its doors, but the fact is that Continental is now serving that market and United is almost entirely out of that market, and how do you explain that?

Mr. **Levine**. Well, this is several years later and things are different. United left Cleveland to build a new hub in Dallas. Continental owns a CRS system. New entrant airlines are no longer a problem. Continental's efforts in Cleveland are new, and we have not yet seen what will happen there.

Senator **Metzenbaum**. Does Continental share its CRS system with Eastern and Texas International?

Mr. **Levine**. Well, Texas International does not exist as an airline any more, Senator.

Senator **Metzenbaum**. What are the airlines?

Mr. **Levine**. Eastern and Continental are the airlines owned by Texas Air, which owns SystemOne, and obviously in those places where Eastern or Continental has a considerable amount of market domination, the CRS works for them in the way it works for United or American somewhere else.

Senator METZENBAUM. You have been on the inside of this industry as a CEO of an airline and on the outside as a policymaker and scholar. You have given a great deal of thought to this subject and concluded that divestiture is the only workable remedy. Those who oppose divestiture say that without the incremental revenues or extra profits which an airline owner can earn from the additional bookings, a non-airline vendor may not have the same incentive to develop and advance the technology of the system. Is there any merit to that argument and, if not, why not?

Mr. LEVINE. I think there is no merit whatever to it. There would be several competing systems. Since they couldn't compete by offering financial inducements designed to obtain incremental revenues, they would compete on the basis of the service and functionality. They would no longer be inhibited by the need to make the system in some ways less useful to the customer in order to produce incremental revenue for the airline.

CRS system owners join travel agents in giving a traveling customer something less than what he or she really wants. By steering that business to the airline owner of the system, the system vendors make money. Divestiture would end that use of CRS's and force them to focus on customer service.

Senator METZENBAUM. How would you phrase the consumer disclosure of travel agent incentives? How would you go about doing that?

Mr. LEVINE. I have thought about that, Senator, but I do not have currently a form of words. It ought not to be done too generally and bureaucratically. "From time to time certain incentives may be paid by some airline or another to me," really won't do. It ought to be more like, "You should know that right now I am in an incentive program with American and they are offering me a 50 percent commission bonus this month if I increase my market share," or something like that will make the disclosure very direct.

I do not think that you will in fact see very many of those disclosure statements, because I think that many of these incentive practices would go away pretty quickly if travel agencies had to make statements like that to their customers.

Senator METZENBAUM. I am frank to admit that there may be some antitrust aspects to that question of providing undisclosed travel agent bonuses for certain flights as compared to others. I would like to explore that subject further, but I'm afraid our time is running out.

Senator Thurmond, do you have any questions.

Senator THURMOND. Mr. Chairman, I just have a few of Mr. Levine.

Mr. Levine, you state that CRS vendors are charging booking fees that are higher than it costs the vendors to operate the systems. Is it not true, however, that it would cost a non-CRS airline more than the booking fee to write those tickets?

Mr. LEVINE. Only if they had to do it without automation. But assuming that automation is used, the studies that have been done, which have attempted to isolate what it would cost to run a standalone booking system, seem to suggest that somewhere between 50 cents and $1 a booking, 50 and 85 cents, some numbers like that are probably the current cost of running a CRS.

Senator THURMOND. Mr. Beauvais, you indicated in your prepared testimony that bias still exists in the way flights are displayed. Would you please elaborate and indicate whether it is possible to remove every kind of bias from such a system, even if the system is not owned by an airline?

Mr. BEAUVAIS. Let me answer the second part first, if I may, Senator. Since there is so much information out there, you have to choose how to present it, just as you choose what order to put the pages in a book in. The question is whether you are presenting it in the way you think will be most useful to the customer or whether you are presenting it in the way that is designed to sort of mislead the customer about what is out there.

There are lots and lots of choices, and the most obvious one is the choice of connecting point and connecting flights. Under the current system, non-stop flights are displayed relatively fairly, although we have seen this morning that you can manipulate schedules and other things to affect that display.

Connecting flights are displayed using an algorithm, using a choice made by the system vendor of what connecting points will be used and what the criteria will be for picking one connection over another, and in our hub-and-spokes systems an enormous amount of traffic moves on connections, you can bias quite a lot of business that way simply by picking some connecting points rather than others or some standards for connections rather than others.

Senator THURMOND. Mr. Levine, does the advantage which you say United and American have by virtue of its position prior to deregulation erode over time? In other words, as contracts expire after 3, 4, 5 years, does such an advantage disappear.

Mr. LEVINE. The advantage will tend to be reduced, yes, particularly in areas around hubs that have become dominated by some airline other than United or American. But in lots of parts of the country, which are on spokes to a number of systems, there is no special reason why a travel agent would pick one vendor over another. If an agent has already signed up with American and United and faces these liquidated damage and rollover clauses, it will tend to continue on. It has been locked in.

To the extent that those impediments are removed, yes, over time I would expect competition to become more even, but that is a long time and a lot of bookings made in the meantime and a lot of people not getting the flights they are paying for.

Senator THURMOND. Mr. Levine, if there are the kinds of problems you suggest in the CRS industry, how do you explain the level of competition that does exist and the rapid and extensive growth of this industry?

Mr. LEVINE. Well, the reason why we have had such rapid growth in the CRS industry, Senator, is that it appears to be almost impossible to run a major airline without owning a CRS and getting the incremental business that comes from its services, as well as the revenue that comes from booking fees. There has been a lot of expansion in self-defense. I think there is no question about that. A travel agent simply must have a CRS to do business and airlines need to offer their services through them as well. Even if they were operated neutrally, we would continue to see growth in these systems. Right now, with their power to produce incremental revenue, it is pretty obvious why it is airlines that want to have them.

Senator THURMOND. Let me ask you a question. I have some friends who are going to Florida shortly after Christmas to spend several days and the rates are so much higher than they ordinarily would be. Why is that?

Mr. LEVINE. Well, I do not know what flights they have requested or when, but obviously airlines, like restaurants and theaters, often charge more at peak times and make their discounts less available at those times when they can fill all the seats anyway, and it is possible that your friends are experiencing that.

Senator THURMOND. Well, should they take advantage of the public and charge more because there is a demand for more seats, or should they treat the public the same year-round?

Mr. LEVINE. Well, I think the basic economics are that you can charge much of the public less much of the time if you can charge some of the public enough to even out demand and supply at peak times. I think that kind of pricing is acceptable, even though it may irritate people who have peak travel demands.

Senator THURMOND. Thank you very much. That is all I have.

Senator METZENBAUM. Senator DeConcini?

Senator DECONCINI. Thank you, Mr. Chairman.

Mr. Beauvais, Senator Metzenbaum raises this question of divestiture. All three of you have been in the business of deregulation and free enterprise and we all claim that that is what we want and we do not want Congress taking away anything from anybody, but are we not really talking about a monopoly here or a near monopoly. In the fact I think you, Mr. Beauvais, indicated, or maybe it was Mr. Magary, that over 70 percent of all reservations are made through these two systems. That certainly leads this Senator to believe that there is not a level playing field and we have permitted a monopoly to develop. This Congress and the people of this country have firmly come out in favor of the free enterprise system. But they have also on many occasions, favored some controls even to the extent where the court has acted to force divestitures when there are clear monopolies.

It just seems to me that what you are telling us here is that those of you who are still independent airlines, you may be a vanishing industry and a vanishing competitor due to this system that is there, based on 15 airlines that have been merged, you said, Mr. Magary?

Mr. MAGARY. Yes.

Senator DECONCINI. It seems to me like we have got a serious problem and Congress ought to do something and divestiture has to be a consideration.

Mr. Beauvais, in your written testimony you comment on the booking fees charged by the airlines and go into it in some length, and obviously you feel that these fees are too high. Based on the growth of your own airline, America West, the economics of it, would it be possible for America West to obtain or create its own computer reservation system?

Mr. **Beauvais**. Not in the near term. The investment necessary for America West to create its own system is a significant amount of money and it goes well above $100 million.

Senator **DeConcini**. It would cost something like that for you to become a competitor with the other two?

Mr. **Beauvais**. That is correct, for us to own our own system, develop our own system.

Senator **DeConcini**. What system do you use now?

Mr. **Beauvais**. Well, we are a non-vendor airline. We are a cohost in the systems that do exist today. We buy our——

Senator **DeConcini**. What does that mean?

Mr. **Beauvais**. We pay our booking fee to SABRE, to APOLLO, to all of the systems, to the PAR system and so forth.

Senator **DeConcini**. So you can have that kind of an arrangement?

Mr. **Beauvais**. Yes.

Senator **DeConcini**. And I presume that is costly?

Mr. **Beauvais**. It is both costly and we are probably one of the closest observers of the biases that exist and we are well aware that they still exist, we are well aware that they are still very serious and we are well aware that it creates a disadvantage for us when we compete with the carrier owners in the marketplace.

Senator **DeConcini**. Well, Mr. Beauvais, have you called the biases to the attention of the system or the airlines——

Mr. **Beauvais**. Yes.

Senator **DeConcini** [continuing]. Or do you dare do that?

Mr. **Beauvais**. We do.

Senator **DeConcini**. And how do you do that, with a written memo or a telephone call? And what is the reaction.

Mr. **Beauvais**. Most of it verbal because it is an issue that——

Senator **DeConcini**. It is changing so fast?

Mr. **Beauvais**. Yes, they do, these change daily practically, and some are dealt with and some are not. Let me give you an example that is pretty easy to follow, because these tend to be very complex.

We initiated service to Chicago Midway Airport. Now, we started that service about a year and a half ago, and in the APOLLO travel agents, when you access service to Chicago, you can access it by making it airport specific or you can call it CHI, Chicago in general. And in the APOLLO systems, if you would access CHI, only the service at O'Hare would be shown, even though there was effective direct, non-stop service out of Midway. You would have to access Midway specifically.

About 6 months after that, United made a decision to instigate service at Midway. After United started service to Midway, if you would at an APOLLO agency use that same access reference of CHI, both services would be shown. All of a sudden there was a change and it was unilateral in the APOLLO agency.

Senator **DeConcini**. Just to follow that up, did you ask them to include Midway after your airline started to provide service there?

Mr. **Beauvais**. Yes, we did.

Senator **DeConcini**. And they said no?

Mr. **Beauvais**. They said it was not within the parameters have built that is equally applied to all airlines.

Senator **DeConcini**. And within 6 months it was.

Mr. BEAUVAIS. Yes.

Senator DECONCINI. I think you rest your case, as the lawyers say.

Thank you, Mr. Chairman.

Senator METZENBAUM. Mr. Beauvais, I chided you a bit about supporting divestiture, but I had forgotten, until my staff just pointed out to me, that I have probably one of the strongest divestiture bills around here, in which I would require the oil companies to divest themselves of their service stations. [Laughter.]

So, before somebody else points that out, I want to point out my own inconsistency on that subject.

Thank you very much, gentlemen.

Our last panel consists of Carl Bryant, president, Mid-America Chapter, American Society of Travel Agents, Columbus, Ohio; and David Swankin, Consumer Federation of America, Washington, DC.

Mr. Bryant, we are very happy to hear from you, sir, and we are particularly happy to welcome somebody from my own State.

A PANEL CONSISTING OF CARL L. BRYANT, PRESIDENT, MID-AMERICA CHAPTER, AMERICAN SOCIETY OF TRAVEL AGENTS, COLUMBUS, OH, AND DAVID A. SWANKIN, CONSUMER FEDERATION OF AMERICA, WASHINGTON, DC

Mr. BRYANT. Thank you, Mr. Chairman. I want to thank you for the opportunity to appear here today. I am Carl Bryant, a working executive for a travel agency in Columbus, Ohio, and also, as you have previously mentioned, president of the Mid-America Chapter of the American Society of Travel Agents.

Airline computer reservation systems are critical tools in the sale of air transportation. At the present scale of airline operations, the nationwide sale of transportation without computerized reservation systems and ticketing, it would be impossible to approach the sale of transportation at a reasonable cost.

The problem is that choices are extremely limited. American and United, as you have previously heard, represent about 70 percent of the market, the other systems picking up their share, and apparently Delta and Northwest, TWA's PAR system dropping down in rank in their market share.

The bargaining for lease and for purchase of these systems is not a negotiation amongst equals. While some CRS vendors have maintained competition among vendors enables travel agents to extract valuable concessions in these negotiations, the fact is that most of the erroneous contract terms are not negotiable in any meaningful sense.

Provisions for liquidated damages, minimum usage, and rollover are the contract terms for the whole system whenever it is expanded, are in a class of "must have" or "take it or leave it" terms. In addition, there are many other one-sided indemnifications which will reduce services, or no warranties on vendor performance, and the complete freedom to use agent generated data without compensation to the travel agent.

The typical travel agent is a very small business, one which will produce about $2 million per year in gross revenues. That travel agent has little or no leverage and must agree on the onerous terms in order to secure service that is essential to his business for survival. When several of these terms are forced on the small travel agent, it is nearly impossible to sign a contract for less than a 5-year term. The vast majority of the agents are also forced to sign contracts which include liquidated damages, which you have referred to previously several times.

I would like for you to consider in particular the following actual case of a small travel agent, with $2 million in gross annual bookings. This agent has been in business in Cleveland, Ohio, for some 20 years, and I know that your very favorite Cleveland location should have some interest to you in this particular circumstance.

Senator METZENBAUM. To the Senator from Ohio, every location is favorite.

Mr. BRYANT. I realize that, sir, and being from Columbia I appreciate that, but in your own background I think it is much more important.

They have had the APOLLO system and this was fine, because United had some 210 departures a day. They wanted to add a printer about a year ago and, due to the rollover provisions, they were forced to sign a new 5-year contract. Shortly thereafter, United reduced drastically their services in Cleveland, down to approximately 20 flights a day. Now, this service that had been sold to the agent—and I am deviating slightly from my prepared statement here, but that service that was sold to the agent no longer provided the service to the agent nor his clients on the basis that was originally sold.

Because of this he wanted to change vendors. However, the fact that he could lower his monthly fees by some 50 percent with another vendor, he has been forced not to do this because of liquidated damages. The liquidated damage clause in his contract at this time amounted to $93,000.

In effect, the booking fees that he was guaranteeing the APOLLO system to earn was $67,000. I think that is based on conditions that no longer exist in his market and he is trying to serve his clients a little better.

Senator METZENBAUM. Could you wind up, please?

Mr. BRYANT. Certainly.

I would like to say one other thing, and that is that ASTA has submitted to the Department of Transportation a petition for rulemaking, and it has been delayed somewhat. I would like to call that to your attention, because you mentioned earlier to Mr. Scocozza, just after I arrived, that you would like to see them speed up and I would like to see this occur also.

In the interest of time, I will close with that and ask that the total prepared statement that was submitted to your office be made a matter of the record.

Senator METZENBAUM. All of the statements submitted will be included in the record.

Mr. BRYANT. I will certainly be glad to answer any questions. Thank you.

[The prepared statement of Mr. Bryant follows:]

TESTIMONY OF
THE AMERICAN SOCIETY OF TRAVEL AGENTS, INC.

PRESENTED BY
CARL L. BRYANT, CTC

BEFORE THE
UNITED STATES SENATE
COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON ANTITRUST,
MONOPOLIES & BUSINESS RIGHTS

December 10, 1987

Thank you for the opportunity to appear before this distinguished committee. As a member of the American Society of Travel Agents, Inc., the world's largest association of travel professionals with over 22,000 members in 128 countries representing approximately 11,000 travel agents in the United States, it is my pleasure to help provide some insight into the problems consumers and travel agents encounter with the airline computer reservations systems. As an executive of a working travel agency in Columbus, Ohio, and as the President of ASTA's Mid-America Chapter, I draw upon my own experience and that of many other travel agents from whom I hear regularly about these issues.

We applaud your initiative, Senator Metzenbaum, in convening these hearings. Airline computer reservation systems are critical tools in the sale of air transportation. It is fair to say that at the present scale of airline operations the nationwide sale of air transportation, without computerized reservations and ticketing, would be impossible at anything approaching a reasonable cost.

Travel agents rely upon their computers for the latest information on airline service, and must depend upon that information to be complete, accurate and reliable. Approximately 97% of the 29,000 agency locations in the United States access information in their computers every business day. Millions of messages are sent back and forth from agents to airline vendors. These vendors provide the essential link between travel agents and the actual provider of travel services. Agents simply must have computer systems in their offices in order to compete effectively in today's highly competitive market.

The problem is that choices of systems are extremely limited. American and United, two of the largest airlines, control over 70% of the market. Eastern's system is having limited success in penetrating the market while Delta and TWA/Northwest's PARS system have dropped down in their rank of market share.

Since the vendors also know that the travel agent must have a CRS system, the bargaining for lease or purchase of these systems is not a negotiation among equals. While some CRS vendors have maintained that the competition among vendors enables travel agents to extract valuable concessions in these negotiations, the fact is that the most onerous contract terms are not negotiable in any meaningful sense. Provisions for liquidated damages, minimum usage and roll-over of the contract term for the whole system whenever it is expanded are in the class of "must have," "take it or leave it" terms for the vendors. In addition, the form contracts demanded by the vendors typically include one-sided indemnifications, the unilateral right to change prices or reduce services, limited or no warranties on vendor performance, complete freedom to use agent-generated data without compensation, unilateral rights to cancel, unjustified restraints on the interconnection of other equipment and oppressive forum selection clauses that expose the agent to lawsuits far from its place of business.

Some of the very largest travel agencies may be able to remove these provisions from their contracts, but the typical agent is a very small business, one that books less than $2,000,000 per year in travel services. That agent has little or no leverage and must agree to the onerous terms in order to secure service that is essential to his business survival. The result is that the clock starts running again every time the agent expands his business and adds a new piece of equipment. The contract cannot be escaped even if the equipment becomes obsolete or the airline services offered in the agent's home market change completely. And in view of the limited warranties, and one-sided guarantees, the agent receives little to no compensation even if the system does not work.

Agents select their CRS based upon a combination of many factors. Location, markets served, amount of supplier information in the system, computer capabilities and compatibility with other systems, access to non-air suppliers, ability of employees to operate the system, reliability of the vendor, promise of future enhancements, ability to service clients, and overall reliability of the equipment play a major role in determining which system to select.

Several contract terms are being forced upon small travel agents. It is nearly impossible to sign a contract for less than five years. The vast majority of agents are also forced to sign contracts which include liquidated damages which far exceed the actual cost of operating the system. The vendors require agents to pay not only the normal monthly charges contained in the contract, but also the booking fees that the vendor expected to receive from other airlines over the life of the contract. For example, for an average agent who cancels their contract with two years remaining, the remaining monthly charges may amount to $24,000 while the liquidated damages established by the carrier equal $53,280 (6 terminals x 200 transactions x $1.85 booking fee x 24 months remaining), more than twice the actual operating cost.

Consider the following actual case of a small travel agent ($3 million in annual gross bookings) in business in Ohio for 20 years. This agent has the Apollo system, which was fine as long as United was a major factor in Cleveland. About a year ago the agent wanted to add a new printer to the Apollo system. United insisted that the entire contract be rolled over into a new five-year term. There are about four years to go. Meanwhile United has cut service at Cleveland from 210 departures to 20 departures. Another CRS vendor, which is now the more dominant Cleveland carrier, offers a system with lower monthly fees and no transmission charges, an effective reduction in the agent's costs of about 50 percent, as well as last seat availability and immediate seat confirmations that better serve the agency's clients on the airline services they will now primarily use out of Cleveland.

But the agent cannot switch systems because the liquidated damages clause would require the payment of $93,000 to United. Two-thirds of that amount is based upon the per-segment booking fees that United earns from other airlines whenever an Apollo agent books a non-United flight segment.

This agent has, in effect, become the guarantor to United that it will earn $67,000 in booking fees from other airlines, based on service conditions that no longer exist. Underlying this scheme is the bizarre idea that the equipment supplied by Apollo to an individual agent is unique and therefore unusable by another travel agent. Nothing could be further from the truth, but the effect of the Apollo contract is to eliminate the duty of the CRS vendor to mitigate damages by leasing the equipment elsewhere, even though that same vendor is responsible for the change in airline services that undermined the agent's original choice of CRS system.

Both United Air Lines and American Airlines, the other dominant vendor, have been very aggressive in enforcing liquidated damages clauses. Both carriers have filed numerous lawsuits around the country against travel agents who have refused to pay the exorbitant liquidated damages penalty. In one such case United is trying to hold the travel agency's owners personally liable for over $450,000 in claimed damages!

So why not just turn off the system and add another system? Today's contracts contain minimum use requirements which force agents to keep the system operational. The minimum use requirements are usually so high that adding a second, more compatible system is impossible unless the agent increases its business substantially.

Most agents cannot afford two systems, and tying two systems into automated accounting functions is generally so expensive that the efficiency of operations is affected.

Essentially, the only option is to live with an obsolete system or find a vendor who will buy out the contract. Eastern

Airlines has recently undertaken an aggressive program of buying out other vendors' contracts, and has been sued by American.

Fortunately vendors are converting their systems to personal computers. Now systems will have the capability of not only making reservations but allow the use of other software products. Unfortunately, new contracts covering the new hardware limits the usage to only those functions which the vendor feels are appropriate. While it is understandable that agents are prevented from tampering with the system in such a way as to damage the hardware or destroy data, it is an unreasonable restraint to prohibit use of equipment which is compatible.

Finally, the warranties and guarantees substantially favor the vendor and provide little protection for the agent. They amount to little more than a best efforts commitment and often exclude liability even for the vendor's own negligence.

Agents do not switch systems on a whim. Agents contemplate switching systems because the old system does not meet their needs and they want to have a better system in their office. Price is definitely not the only consideration for an agent. As I described earlier, there are many factors which contribute to agents selection of their computers. What everyone fails to recognize are the hidden costs associated with switching systems that agents consider. Employee training on a new system is costly in both training costs and time away from doing business. Having one system inoperable while another system is being set up in the office means business is lost while the system is down. Procedures for handling clients have been established on the old system and a new system may change how the agent does business with them.

Consumers are affected when an agent continues to operate with an obsolete system. If the system does not provide access to the suppliers requested by the client, agents may not be able to provide needed services or will spend more time booking directly with the supplier.

The current CRS contracts provide a barrier to entry by other airline vendors. Agents operate on a very small profit margin, somewhere between one and three percent. Paying $50,000 in liquidated damages by such agents is impossible. So while agents may want to have a more efficient system in their office, it's impossible from a financial standpoint to switch systems.

It's also impossible for any new airline or non-airline vendor to enter this market. About 97% of the agents already have a system in their office. Most of those agents are locked into their contracts until 1990 or later. Most agencies are small businesses with little room to pay excessive liquidated damages or take on the expense of a second system. To enter the CRS market, a vendor would have to either buy out all the liquidated damages required in CRS contracts or give their system away for free.

A new vendor could only compete in this market if all the major airlines participated in the system. It is doubtful that the vendor carriers would participate in a new competing system.

What should be done? ASTA has submitted to the Department of Transportation a petition for rulemaking, proposing that DOT adopt a standard set of CRS contract terms that would eliminate the principal abuses connected with CRS contracts. We understand that DOT will not act on that petition until it concludes its latest, more general study of CRS market conditions. That study, one of a series by various government agencies, has been underway since February, 1987. DOT has stated that the study will be concluded in early 1988. Considering the number of studies of the CRS problem and the extraordinary length of time required to complete them, ASTA believes that the Congress must intervene if DOT does not take prompt and forceful action to restrain the market power that has been found to exist by virtually every disinterested study of the subject.

Senator **Metzenbaum**. Thank you very much.

Our last witness is David Swankin, actually the first witness speaking for the consumers, the Consumer Federation of America.

Mr. **Swankin**. Thank you, Senator Metzenbaum.

My name is David Swankin and I am an attorney in private practice——

Senator **Metzenbaum**. Bring the mike closer to you.

Mr. **Swankin**. I am an attorney in private practice in the firm of Swankin & Turner, in Washington, D.C., and on the issue of airline computer reservation systems I serve as a special adviser to the Consumer Federation of America.

I have attached my biographical sketch, and you will note that in 1964 I served under Esther Peterson as the first Director of the White House Office of Consumer Affairs, under Lyndon Johnson.

The Consumer Federation of America, which I represent today, is the Nation's largest consumer organization. I also serve as the Washington counsel to the International Consumer Research Institute, a private Wisconsin based consumer research firm. In June of 1987, ICRI published a four-page report on the CRS issue entitled "Scams In the Sky." I am attached it to and making it a part of this testimony. When you read "Scams In the Sky," you will readily understand why the CFA believes consumers are ill served by carrier owned computer reservation systems and why CFA believes that divestiture of these systems may be the only solution to cure the CRS problem.

"Scams In the Sky" begins by posing three true or false questions. First, if you make your airline reservation well in advance, you will get a lower fare than if you wait until the week of your departure, true or false? Second, if you are ready to make your reservation for a flight, you will get equally low fare from any accredited travel agency—

Senator **Metzenbaum**. You are speaking so rapidly that I cannot understand you.

Mr. **Swankin**. I will try to go slower.

If you are ready to make your reservation for a flight, you will get an equally lower fare from any accredited travel agency, true or false? And, third, if an airline advertises bargain fares on a route, a fixed number of seats will be sold at that price, true or false?

All of those statements are false. In August of 1987, Esther Shapiro, the highly respected Director of the Consumer Affairs Department of the City of Detroit, and a former President of CFA, reported as follows on her radio show:

> The airlines can now tell how close a flight is to being sold by a competing airline on the same route. This gives them the unique ability to raise or lower the ticket prices displayed for a given flight almost literally from minute to minute. If one line sees that it has a large number of empty seats on a flight from Chicago to Denver, while the competing flight is also half empty, it can quickly make more discount seats available for that flight through its computer, to attract last minute passengers. Thus, passengers who make their reservations a day or two before the flight may well pay less than passengers who booked their tickets in advance. But if the competing flight is full, the airline can cause its computer to show no remaining discount seats, even though the plane may still be half-empty, so it can charge last-minute passengers the full fare. How can you decide the best time to make your reservations? A roll of the dice might help. I can't think of anything more reliable.

With deregulation, which CFA supported and still supports, there have been some great bargains for consumers who travel by air. But because of the way CRS is owned and operated, shopping for the best buy has become almost impossible.

A few years ago, the carrier owners of the CRS systems programmed them to give preferential treatment to their own flights, leading to the adoption of new rules by the then Civil Aeronautics Board that eliminated those most blatant forms of bias. But CRS owners have come up with new, far more sophisticated ways of gaining competitive advantage at the expense of consumers.

In my prepared testimony, Senator Metzenbaum, I have quoted extensively from Administrative Law Judge Yoder, who at the DOT heard the U.S. Air-Piedmont merger case and has recommended against allowing that merger. In his decision, he explained in great detail the relationship, the interrelationship between the computer reservation system, frequent flyer programs, the hub-and-spoke system, the merger policy of this administration, slot allotment, and he explained at least to me, who is not an antitrust expert in a very easy to understand fashion how all of these things have become intertwined under deregulation and how the computer reservation system is the means by which this excess monopoly power and market power is carried out.

Senator METZENBAUM. But his recommendation was reversed, it went to——

Mr. SWANKIN. Yes, his recommendation was not accepted.

The travel agent is caught in the middle in our opinion. On the one hand, the commission override system forces the agency to favor particular carriers, whether or not their particular fare on any particular flight on any given day is lowest, but it is the travel agent who has to face the irate consumer.

As we put it in "Scams In the Sky," when you call a travel agent and ask for the lowest possible fare on a flight and are told——

Senator METZENBAUM. Could you wind up, please, Mr. Swankin?

Mr. SWANKIN. Yes, I will, I will end the quote. It is just that the travel agent on the one hand is who the consumer goes back to if he finds out that the person on the seat next to him has paid a lower price, even though he bought the ticket later.

We have approached the National Associations of Attorneys General Antitrust Committee, I spoke before them early in November, and I am pleased to say that they have opened an investigation into the CRS, at least an inquiry into CRS over and above their inquiry into deceptive consumer advertising practices on which they are ready to report this weekend.

We have concluded at CFA that the two choices really are to regulate these abuses or to divest, and it seems that divestiture—I agree with you personally that it is a severe remedy, but in this case it might be the best remedy, because it would put information into neutral hands, there would be no advantage in a neutral CRS owner to giving a bias to one particular airline or another, and I think that information be comes critical in this very highly concentrated industry.

Thank you.

[The prepared statement of Mr. Swankin follows:]

CFA Consumer Federation of America

TESTIMONY OF

DAVID A. SWANKIN, ESQ

ON BEHALF OF THE

CONSUMER FEDERATION OF AMERICA

before the

SUBCOMMITTEE ON ANTITRUST, MONOPOLIES, AND BUSINESS RIGHTS,

OF THE JUDICIARY COMMITTEE

on

COMPUTER RESERVATION SYSTEMS (CRS)

December 10, 1987

1424 16th Street, N.W., Suite 604 • Washington, D.C. 20036 • (202) 387-6121

My name is David A. Swankin. I am an attorney in private practice, and on the issue of Airline Computer Reservation Systems (CRS), serve as a Special Adviser to the Consumer Federation of America. My biographical sketch is attached.

The Consumer Federation of America (CFA), which I represent today, is the nation's largest consumer organization. Comprised of national, state, and local consumer groups with a myriad of different interests, CFA's programs include advocacy, education, and the examination of issues of public concern and public policy.

I also serve as Washington counsel to the International Consumer Research Institute (ICRI), a private Wisconsin-based consumer research firm. In June, 1987, ICRI published a 4-page report on the CRS issue entitled "Scams in the Sky". I am attaching it to, and making it part of this testimony. When you read Scams in the Sky, you will readily understand why the CFA believes consumers are ill-served by carrier-owned computer reservation systems, and why CFA believes divestiture of these systems may be the only solution to cure the problem.

Scams in the Sky begins by posing three true or false questions:

(1) If you make your airline reservation well in advance, you will get a lower fare than if you wait until the

week of your departure. (True or false)

(2) If you are ready to make your reservation for a flight, you can get an equally low fare from any accredited travel agency. (True or false)

(3) If an airline advertises bargain fares on a route, a fixed number of seats (the number may vary from flight to flight) will be sold at that price. (True or false)

All of those statements are false. In August, 1987, Esther Shapiro, the highly respected Director of the Consumer Affairs Department of the city of Detroit (and a former President of CFA) reported as follows on her regular radio show:

> "The airlines now can tell how close a flight is to being sold by a competing airline on the same route. This gives them the unique ability to raise or lower the ticket prices displayed for a given flight almost literally from minute to minute. If one line sees that it has a large number of empty seats on a flight from Chicago to Denver, while the competing flight is also half-empty, it can quickly make more discount seats available for that flight, through its computer, to attract last-minute passengers. Thus, passengers who make their reservations a day or two before the flight may well pay less than passengers who booked their tickets in advance. But if the competing flight is full, the airline can cause its computer to show no remaining discount seats, even though the plane may still be half-empty, so it can charge last-minute passengers the full fare. How can you decide the best time to make your reservation? A roll of the dice might help. I can't think of anything more reliable."

Esther Shapiro went on to relate a new airline joke, where the captain turns on the intercom to announce, "Please fasten your seat belts, put seat backs and trays in an upright position, and don't compare your ticket fare with the person besides you."

With deregulation (which CFA supported and still supports) there have been some great air bargains for consumers. But because of the way CRS is owned and operated, shopping for the best buy has become almost impossible.

A few years ago, the carrier-owners of the CRS systems programmed them to give preferential treatment to their own flights, leading to the adoption of new rules by the then Civil Aeronautics Board (CAB) that eliminated these most blatant forms of bias. But CRS owners have come up with new, far more sophisticated ways of gaining competitive advantage at the expense of consumers.

In the airline industry today, pricing is a product of what is known as "yield management". In the recent hearings at the U.S. Department of Transportation on the US Air - Piedmont merger, the Administration Law Judge who heard that case, Mr. Ronnie A. Yoder, (whose recommendation that the merger be disallowed was rejected), described how yield management operates, how CR systems are the tool by which yield management is practiced by carriers who own such systems, and how the process works to the disadvantage of competitors and consumers. In the words of Mr. Yoder (with footnotes and citations omitted):

> "Yield Management, Fare Discount Seat Allocation, and Secrecy. Yield in any city-pair is a function of

the posted fares and the number of passengers flying at each one. The number of passengers flying at each fare is itself a function of a mix of discretionary and non-discretionary passengers as well as the number of seats available at each fare.

"Deregulation has produced a plethora of different fares below the regular coach or full Y fare. Mr. James testified that USAir throughout its system has over 7000 individual fares below the full Y fare, including lower Y fares. Even if all the fare levels were known and were static, however, these posted prices would not describe the effective selling price in the market, which is a function of the number of seats made available for sale in each fare category, which is in turn a function of competition in each market...

"Yield management is the common term used in the industry for managing inventory in order to maximize yield. The principal goal of yield management or revenue enhancement is to maximize revenue, i.e., to charge each passenger as much as possible and meet load factor break even requirements.

"A yield management system monitors how bookings are coming in relative to [the carrier's] plan for discount seat allocation. If a flight is not booking according to plan, either above or below the plan, the computer advises a yield management analyst, who may adjust the capacity levels for discount-seat categories.

"Carriers differ in their ability to allocate seats. For example, some carriers are able to allocate certain discount capacity for through and connecting passengers so that it will not all be used by local traffic...

"Airline yield management systems, and the techniques used and continuing adjustments made to capacity levels, are proprietary. Such information is held secret by an airline in order to be able to make a strategic pricing move, without it being instantaneously detected by its competitors.

"Yield data is publicly available from DOT sources only after a year's lag. Load factor information is also publicly available, by only after a one-year lag...

"Such secrecy may be pro-competitive if there is

> an oligopolistic market with relatively few competitors, because it facilitates effective pricecutting. Oligopoly sellers have more of an incentive to cut prices if they know that their competitors cannot detect such manipulation and match them immediately...
>
> "[However], price changes may only be procompetitive if they are known to consumers and competitors, and secrecy denies information to consumers concerning the availability of fares and the timeliness (duration) of such availability, even though accurate consumer information is an important characteristic of a free market. Yield management and secrecy combine to make very difficult the consumer's attempt to buy the cheapest ticket at the right time from the right carrier. Discount levels and availability may vary on a daily basis and render airline ticket purchase by a passenger akin to a lottery. Moreover, secrecy also denies accurate information to potential entrants.
>
> "The radical altering since deregulation of the price and yield mechanism by which fares are actually determined raises substantial public interest consumer concerns and competitive concerns. The record clearly demonstrates that the actual selling price of airline tickets is elusive and that the only adequate indication of effective selling price is yield. Through increasingly sophisticated CRS systems, carriers are able to manipulate the allocations of seats in their different fare categories, or "buckets," until the flight leaves. Since a year or more may pass before a competitor learns of the actual selling price of the seats on the plane or the load factor, competitive information about posted prices is largely illusory. Consumers are unable to determine the best time, price or carrier in a lottery-ticket yield management system. Fare competition in the short term is based at best on only rough knowledge of what is actually being offered. The dynamics of the process permit no finer comparison. Indeed, increasing technological sophistication will make actual fare matching an even more difficult and costly manner."¶

Addressing the way in which CR systems act as a barrier to entry by small carriers into new markets, Mr. Yoder wrote in his opinion:

> "Computer reservations systems (CRS) also

> constitute an entry barrier. Through display bias and travel agent loyalty, they make it more difficult for the potential entrant to respond to supracompetitive fares and services..."

Putting all the pieces together, Mr. Yoder explains the commission override system, which is the reason for travel agent loyalty, as follows:

> "Commission overrides, by inducing carrier loyalty in the same manner as a frequently flyer program -- in the case among travel agents -- tend to induce travel agents to route traffic in favor of carriers with a large share at that city..."

Dr. Severin Borenstein, Associate Professor of Economics and Public Policy at the University of Michigan, and an advocate of CRS divestiture, has stated that commission override give travel agents "a frequent-booker plan with the airlines, in the same way that the travelers have a frequent-traveler plan." Moreover, Dr. Borenstein has stated that "the incentive to pay these overrides will grow as a carrier gets larger in a city."

The travel agent is caught squarely in the middle. On the one hand, the Commission override system forces the agency to favor particular carriers, whether or not their particular fare on any particular flight on any given day is lowest. But it is the travel agent who has to face the irate consumer. As we put it in Scams in the Sky:

> "When you call a travel agent and ask for the lowest possible fare on a flight, and are told there are no discount seats available, only to learn that a

> discount fare is available when you call a different travel agency an hour later, both the customer and first travel agent feel abused."

When your travel agent advises you to book your reservation three weeks before you travel to obtain the lowest fare -- even at the cost of flexibility -- and then you discover that the passenger on the plane seated next to you bought a ticket at the same or lower price the previous day, both the customer and the travel agent see themselves as victims.

And, it is not just consumers and travel agents that are hurt. So are the small airlines, who are too small to purchase CR systems of their own, yet must compete with the big airlines that can own their own CRS. And business who have many employees who fly also are hurt if they must operate in a system that denies them the opportunity to shop around for best price, or instruct their employees to shop around for best price.

Deregulation is not the culprit. There have been many benefits of deregulation. In fact, in highly competitive routes, such as coast-to-coast flights from New York to Los Angeles, prices are significantly lower than they were when the economics of air travel were regulated. But everyone doesn't fly on the competitive routes. Again quoting Esther Shapiro telling of a letter received in response to her program quoted earlier:

> "Between heavily traveled city pairs -- where much competition exist -- it is true that some fares are

> dramatically lower then they ever were in the regulated environment. On the other hand, the poor slob who finds it necessary to fly between two smaller cities -- let's say Decatur to Saginaw, for example, -- winds up paying an outrageous fare, when compared to the fares charged on the more popular routes."

CFA does not advocate a return to economic regulation. Nor do we think that the computer reservation system is solely responsible for all of the wrongs that have emerged since deregulation.

But we note that even the most ardent defenders of deregulation recognize the problems that have been brought about by the current CR systems. In a 1986 report published by the Brookings Institution, entitled The Economic Effects of Airline Deregulation, authors Steven Morrison and Clifford Winston state:

> "The proliferation of fares and schedules under deregulation has raised the possibility of market failure due to incomplete information on the part of travelers."

After discussing the problem of bias, Morrison and Winston state (pp 70 - 71):

> "Best of all, of course, would be an unbiased CRS. Naturally, that idea has occurred to policymakers. In fact, before the CAB went out of business, it adopted rules designed to eliminate certain forms of display screen bias. It left, however, considerable room for ingenious CRS owners to prejudice their systems. Furthermore, United and American may be able to set such excessive access charges for their service as to discourage other carriers from participating in their systems...Unfortunately, there are no market-oriented public policies that eliminate the bias. In principle, bias could be eliminated if comparable CR systems were offered to travel agents by firms that were not air

> *carriers. However, American and United could refuse to participate in the new systems, particularly with regard to making reservations. Given the high costs of developing and maintaining a CRS, this threat has been sufficient thus far to discourage the development of competing systems by noncarriers."* (emphasis added)

CFA is aware of and supports vigorously the efforts of the state attorneys general, acting through the National Association of Attorney Generals (NAAG), to address many of the unfair and deceptive practices that have emerged in the airline industry since deregulation. The NAAG report, due to be released in a few days, promises to offer solutions to many problems faced by air travelers, especially deceptive advertising.

But over the years we have learned that there are, from time to time, problems that cannot be adequately addressed simply by the traditional consumer protection remedies of outlawing deceptive advertising, or unfair practices. Sometimes, there is a need to call for more *structural* remedies.

CRS appears to be one of these problems. Whatever success the AGs have in stopping deceptive practices, more will be required to address the problems related to abuse of market power by misuse of CRS. That is why on November 4, when I had an opportunity to address the NAAG Antitrust Committee, I urged them to look into the antitrust aspects of CRS. We are pleased that the AGs reacted favorably, and I understand that indeed they have established a task group to look into the CRS issue.

Next week, consumer groups including CFA, some travel agents, some small airlines, and some representatives of large corporations whose employees travel frequently will meet in Washington to see whether they are ready to form a coalition to work for a structural solution to the CRS problem, and perhaps other structural problems.

And, the structural solution we will be pushing is divestiture. In its 1985 study on CRS, the Department of Justice recognized the benefits of divestiture, even though that Department -- (the same one that has allowed a merger policy that has turned the airline industry into an industry of a few giants) -- concluded that the costs of divestiture outweighed the benefits. But, as I said, even the Justice Department study recognized the merits of divestiture. The study said:

> "Separating CRS ownership from the airline parent may bring access prices down to competitive levels by facilitating entry and increasing CRS competition. While the anti-bias rules have eliminated the ability of carrier-vendors to earn incremental revenues, the carrier-vendors still retain an entry advantage over non-vendor carriers in markets where the vendors have a major airline presence. Divestiture would eliminate this advantage.
>
> "Divestiture may also have benefits in air transportation markets. Currently, carrier-vendors incur only the marginal cost of booking an airline reservation, while non-vender carriers pay an access fee that may be priced above the vendors' costs. If the access fee is supracompetitive, it will create distortions in airline markets."

The Justice Department was correct in its analysis but, with all due respect, wrong in its conclusions. We urge Congress to give serious consideration to legislation that forces a separation of CRS ownership from the carriers.

Thank you.

SCAMS IN THE SKY

HOW BIG AIRLINES USE THEIR COMPUTERS TO TRICK CONSUMERS

1. If you make your airline reservation well in advance, you will get a lower fare than if you wait until the week of your departure. **(True/False)**

2. If you are ready to make your reservation for a flight, you can get an equally low fare from any accredited travel agency. **(True/False)**

3. If an airline advertises bargain fares on a route, a fixed number of seats (the number may vary from flight to flight) will be sold at that price. **(True/False)**

If you answered "True" to any of these statements, read on – for without telling the public, the big airlines have been changing what informed consumers have been led to believe are the rules of the game.

All three of these statements are false.

These new realities of the airline business are a growing source of concern and frustration to consumers – and to responsible travel agents.

> **At the heart of this anti-consumer behavior is a familiar villain – the computer.**

The nation's largest airlines today control huge data processing systems that are among the most sophisticated in use by any consumer business.

A few years ago, public concern centered on the fact that the two dominant CRS systems used by the majority of travel agents, American Airlines' Sabre and United Airlines' Apollo, were "biased" to give preferrential display to the flights of the computer system's owner. The result: travel agents inevitably tended to book more passengers on American and United.

Travel industry and consumer protests aroused government interest, and the most blatant forms of bias now have been eliminated.

> **But owners of the five largest CRS systems – United, American, Texas Air (Continental and Eastern), TWA and Delta – since have come up with new, far more sophisticated ways of gaining CRS advantage at the expense of the unwitting consumer.**

One trick that already has received some attention is the airline ploy of listing optimistic rather than real flight times in the CRS systems. Since computers can be programmed to favor the shortest flight between two points, travel agents wind up recommending flights on the basis of scheduled times that the airline has no expectation of meeting.

Three other consumer and travel industry problems inherent in big airline ownership of the big CRS systems are illustrated in the True/False choices at the start of the White Paper.

The big airlines that own the dominant CRS systems can tell, for example, how close a flight is to being sold out at any given moment. They also can tell how many seats remain to be sold by a competing airline on the same route.

> This gives the big airlines that own the dominant CRS systems a huge competitive advantage. Acting on this information, the airlines that control the CRS systems have the unique ability to raise or lower the ticket prices displayed for a given flight almost literally from minute to minute.

If United, to pick a hypothetical example, sees that it has a large number of empty seats on a flight from Chicago to Denver – while the competing flight is also half-empty – United can quickly make more discount seats available for that flight through its CRS to attract last-minute passengers.

> **Thus, passengers who make their reservations a day or two before the flight may well pay less than passengers who booked their tickets well in advance.**

But if United sees that the competing flight is full, United can quickly cause its CRS to show no remaining discount United seats – even though the plane may still be half empty – so it can charge last-minute passengers, who it knows have no alternative to that flight, full fare.

> **That is why perplexed passengers sometimes find themselves flying on a half-empty plane when their travel agent had told them that no discount seats were available.**

The unstated reality behind bargain fares is that the big airlines that control CRS systems virtually never have a fixed number of seats available at an advertised bargain price. At various times in the weeks before a given flight, the CRS may show may show 100 seats, 60 seats, 20 seats, or no seats available at a bargain fare – depending on the airline's success in selling the same seats at higher fares.

The only airlines that have little alternative but to put fixed numbers of seats for sale at bargain prices are those which do not control CRS systems.

Another problem derives from your natural consumer belief that because your small travel agent has the same CRS terminals as a much larger agency, both agencies have an equal chance of getting you the lowest available fare on a given flight.

Wrong!

Both agencies may see no bargain fares available for a flight when they look it up on their CRS screen. But as an inducement to larger agencies to lease their CRS system, big airlines often let them book clients at discount fares even when the CRS shows the fare no longer available. (Remember, there is no real limit on the number of seats at any given price.)

> **These consumer abuses – which derive from the fact that the biggest airlines control the only CRS systems available to travel agencies – are a source of growing concern to fliers and travel agents alike.**

When you call a travel agent and ask for the lowest possible fare on a flight, and are told no discount seats are available, only to learn that a discount fare IS available when you call a different travel agency an hour later, both the customer and first travel agent feel abused.

When your travel agent advises you to book your reservation three weeks before you travel to obtain the lowest fare – even at the cost of flexibility – and you then discover that the passenger on the plane seated next to you bought a ticket at the same or lower price just the previous day, both the customer and the travel agent see themselves as victims.

CRS systems certainly have the potential to help travel agencies better serve their customers. Through the quick access they provide to schedules and other reservation systems, the CRS computers can be an invaluable asset to travelers.

> **But when the dominant CRS systems are owned by the big airlines and are used, first and foremost, as a competitive weapon, consumers and travel agents alike – and perhaps government policy makers – have reason for concern.**

This is only one of the air travel issues, moreover, that unites consumers and responsible travel industry leaders.

Other shared computer concerns include:

- **Frequent Flier Awards.** The frequent flier programs that the major airlines are making more complicated by the hour are tracked through the CRS systems. Recent airline efforts to increase the number of miles required for awards and to force frequent fliers to bypass their travel agents and deal with sponsoring airlines directly raises consumer concerns over rules being changed in mid-game.

- **Disguised Fare Hikes.** Recent airline fare increases were announced as "fuel surcharges," with plans to include the surcharges only in the small print in advertising – and to list the surcharges separately on tickets. Unless these "surcharges" are added into the fares displayed by CRS systems, the potential for travel agent and customer confusion is great.

This White Paper was prepared by the International Consumer Research Institute as a vehicle for fostering increased dialogue in the public interest between consumer and travel industry leaders. Other consumer organizations have targeted a variety of issues associated with air travel – safety, lost luggage, extraordinary delays – for increased governmental attention. The ICRI concluded from a recent survey of American consumer leaders, however, that the manipulation of CRS systems by the big airlines is a little-understood issue that warrants more attention by policy-makers.

FOR MORE INFORMATION:

THE INTERNATIONAL CONSUMER RESEARCH INSTITUTE
HENRY S. REUSS FEDERAL PLAZA
MILWAUKEE, WI 53203
(414) 271-1477

ATTORNEYS AT LAW

SWANKIN & TURNER

SUITE 105 1424 16TH STREET N.W. WASHINGTON, D.C. 20036 TELEPHONE 202 462-8800

DAVID A. SWANKIN
JAMES S. TURNER, P.C.
FRED GOLDBERG, P.C.
BETSY E. LEHRFELD, P.C.
DEBI H. TUCKER

DAVID A. SWANKIN

Mr. Swankin is an attorney with his own Washington-based law firm specializing in regulatory and administrative law. He has a broad background in both government and public interest advocacy. His government career included assignments in the White House and the U.S. Department of Labor.

He has provided legal services to numerous public interest and professional organizations. He has been Special Counsel to the National Association of Consumer Agency Administrators, General Counsel to the National Consumers League, Project Coordinator for Indoor Air Quality for the Consumer Federation of America, Special Counsel to the Automobile Owners Action Council, Legislative Counsel to the American Society of Safety Engineers, and Counsel to the Interstate Solar Coordination Conference. He served as Washington Representative for Consumers Union. He has more than twenty years of experience developing consensus positions on highly controversial issues such as safety regulation.

Previously Mr. Swankin served as Director of the Bureau of Labor Standards and Deputy Assistant Secretary, U.S. Department of Labor, where he was responsible for the administration of the safety and health provisions of the Walsh-Healey Public Contracts Act, predecessor to OSHA. He served as the first Executive Director of the White House Office of Consumer Affairs in the mid-1960s.

Mr. Swankin was a member of the original National Advisory Council to the Consumer Product Safety Commission, has served on the faculty of the University of Southern California (Washington, D.C. campus), is a former member of the Board of Directors of the American Society for Testing and Materials, is a former member of the National Academy of Science review panel for the Center for Consumer Product Technology at the National Bureau of Standards, and he served as Vice Chairman of the Subcommittee on Regulation, Administrative Law Section, American Bar Association. He is the President of the Regulatory Alternatives Development Corporation, a Washington-based consulting firm. He is listed in Who's Who in America, and has received numerous public service awards.

EDUCATION
A.B., Economics, 1954, Brandeis University
M.S., Economics, 1957, University of Wisconsin
J.D., 1962, George Washington University Law School

Senator METZENBAUM. Thank you very much, Mr. Swankin.

I might say, as I think about the divestiture question, specifically as it pertains to the gasoline dealers, we are talking about an obvious market. It is not a difficult market to find, to find the operator of a local gas station. When we are talking about somebody else coming in and setting up a new CRS system, it is a totally different kind of matter, but I do not believe that is a major issue before our committee.

Mr. Bryant, I wanted to ask you how much help it would be to the air travel agents or the Society of Travel Agents if they had the right to terminate their contracts and just pay actual damages, instead of liquidated damages?

Mr. BRYANT. Senator, I think it would be a definite step in the right direction. I think that it would be only fair that actual damages should be found, there should be some formula that would be available that could be studied before an agent would make that kind of a decision. But I think that the liquidated damages, as they exist today, are very one-sided.

I think in the case that was cited in the testimony is a very good example of this. He does not have the opportunity to make a change, because market conditions have changed now. There obviously are some actual costs that exist, and I think that the—I cannot speak policy for the American Society of Travel Agents, I want you to understand. I do have in the audience Mr. Paul Ruden, who is an attorney for the American Society of Travel Agents, who might be able to talk policy more than I, but I think that it would be a definite step in the right direction.

Senator METZENBAUM. Thank you very much.

Mr. Swankin, what would be the position of the Consumer Federation of America with respect to giving the travel agent the option of paying actual damages or liquidated damages as determined by some impartial judge, jury or arbitrator?

Mr. SWANKIN. It clearly would be a step in the right direction. It clearly would lead to better, more competition.

Senator METZENBAUM. Well, as the Chair indicated earlier in this hearing, the ball is in the court of the Department of Transportation, and if they do not see fit to take some action or move in order to try to resolve some of these problems that adversely affect the consumers of this country, then we in the Congress would at least take a swipe at it and see what we can do about it.

Before closing the hearing, I want at this point to place in the record a prepared statement by Delta Air Lines on the CRS system.

[The prepared statement referred to follows:]

December 10, 1987

STATEMENT OF
DELTA AIR LINES, INC.
FOR THE
SENATE JUDICIARY ANTITRUST, MONOPOLIES AND BUSINESS RIGHTS SUBCOMMITTEE HEARING
ON
AIRLINE COMPUTER RESERVATIONS SYSTEM

Delta Air Lines appreciates the opportunity to submit its views for the Subcommittee's hearing record on issues relative to airline computer reservations systems. We applaud the Subcommittee's decision to hold a hearing on this important issue. A highly competitive CRS environment is vital to preserving and strengthening the benefits that consumers receive in a deregulated marketplace.

Delta currently is the smallest of the five airline vendors. Despite Delta's aggressive marketing efforts and technologically advanced CRSs (DATAS II and DeltaStar), Delta has had difficulty penetrating the CRS market. A primary cause for this limited success is the CRS market power exercised by the major CRS vendors and, more particularly, barriers to entry purposefully erected by certain vendors to minimize CRS competition.

Competition among CRS vendors benefits the travelling public and CRS users by improving the price and quality of CRS services. The greater the level of competition, the greater will be those benefits. Unfortunately, the market power now exercised by the dominant vendors has stifled CRS competition by making market entry and penetration difficult. Some CRS vendor practices--including in particular segment fee based liquidated damages--have perpetuated the market power of the large vendors.

It is, therefore, appropriate for Congress to consider measures to improve CRS competition by reducing the large vendors' market power. However, Delta believes that before legislation is enacted, Congress should urge the DOT to explore available regulatory options, including informal discussions with vendors and DOT enforcement actions. If the DOT does not act in a timely manner or cannot correct the problems, legislation may well be appropriate.

There are different types of CRS contractual provisions that have raised barriers to CRS market entry and have prevented CRS subscribers from utilizing the systems that best meet their needs. Notable among such provisions are segment fee based liquidated damages, clauses which extend the entire CRS contract when a subscriber adds new equipment or services,[1] and minimum use requirements.[2] These provisions make it difficult for smaller vendors to market their CRSs and for subscribers to take advantage of new technology and services. Thus, such provisions entrench the market domination of the largest CRS vendors and stifle CRS competition, allowing the large vendors to exact terms from subscribers that would be difficult to impose in a more competitive environment.

Congress should encourage the DOT to resolve the problem of CRS market power through informal discussions with vendors and enforcement actions. DOT discussions with vendors have successfully corrected CRS abuses in the past. For instance, shortly after the CRS regulations were adopted, the DOT convinced certain vendors to eliminate biased secondary displays. More recently, the DOT convinced CRS vendors to eliminate elapsed time as a factor in their display algorithms. Another possible

---

1/ American Airlines, Covia (Apollo), and PARS recently announced that they will no longer use roll-over renewal clauses in their standard contracts. However, those actions were taken on a prospective basis and do not affect existing contracts. Because virtually all of those vendors' subscribers remain affected by the roll-over provisions, the recent announcements do not materially lessen the difficulty of entering the CRS market.

2/ To protect itself from similar provisions in the contracts of dominant vendors, Delta recently included minimum use provisions in its CRS subscriber agreements. Delta has already notified the Department of Transportation that it would voluntarily eliminate these provisions if the other vendors eliminated their liquidated damages provisions, roll-over clauses, and minimum use clauses.

tool, enforcement actions, would enable the DOT to focus on those vendors which use offending provisions and would not impact vendors such as Delta which do not use liquidated damages clauses or roll-over provisions.

It should be noted that some CRS contractual provisions that have been criticized do not affect competition, but simply structure the vendor-subscriber relationship. Provisions involving such things as indemnifications, warranties, use of data, and performance standards are necessary to define the parties' rights and obligations and directly affect the price at which the CRS is offered. To require broad warranties or indemnifications, for example, cannot help but increase CRS prices by preventing parties from negotiating for lower levels of protection and associated lower prices. The freedom to negotiate the basic structure of vendor-subscriber relationships produces important differentiations among CRSs. To regulate such freedom could reduce the available CRS offerings. Most importantly, if CRS competition is increased by reducing the large vendors' market power, subscribers will be in an improved negotiating position relative to normal contractual matters and further government involvement should become unnecessary.

Senator METZENBAUM. That concludes the hearing. Thank you all very much.

[Whereupon, at 12:15 p.m., the subcommittee was recessed, subject to call of the Chair.]

APPENDIX

COMMENTS TO U.S. SENATE JUDICIARY COMMITTEE, CRS PANEL.

BY GEOFFREY H. LIPMAN, EXECUTIVE DIRECTOR, IFAPA.

INTRODUCTION.

The International Foundation of Airline Passengers Associations is a non profit organization which researches and represents the interests of passengers with airlines, governments and the travel trade at national, regional and international levels. It is sponsored and supported by the 110,000 Members of IAPA, including 40,000 from the Airline Passenger Association (Dallas/US). Its head office is in Geneva Switzerland, with regional representation in the US and elsewhere.

This submission addresses passenger attitudes to CRS, passenger choice and measures to safeguard passenger interests. It reflects studies conducted by IFAPA during the past year, including a research project at McGill University, Canada, looking at CRS from a passenger perspective. Attachment "A" summarizes the conclusions of this work.

PASSENGER ATTITUDES TO CRS.

Between April and June 1987 IFAPA surveyed some 30,000 airline passengers, of whom more than 7,000 were US residents, on a wide range of air transport issues. Respondents were generally frequent fliers averaging 14 trips per annum. Data indicates some 70% of US respondents' trips were for business puposes and some 30% for leisure.

Two of the sixty four questions dealt specifically with attitudes to CRS:-

"Are you aware that most flight schedules are selected by airlines and agents from computerized listings which contain the flight information of several airlines?"

"Which statement best reflects your attitude to bookings made on computer reservation systems?:-

I trust the agent or airline to select the best schedule once I have outlined my itinerary.
-I prefer to know which criteria are being used to select the schedule I am offered."

1987 IFAPA SURVEY - RESULTS

	N.AMERICA	WORLD			
		all	heavy/med/light		
AWARE OF CRS USE	79%	77%	83%	79%	73%
NOT AWARE	21%	23%	17%	21%	27%
TRUST AGENT/AIRLINE	34%	35%	29%	33%	39%
WANT TO KNOW CRITERIA	66%	65%	71%	67%	61%

These results suggest that 4 out of 5 North American frequent fliers (and marginally less around the world) are aware of the use of CRS as a basis for flight selection. It also suggests that 2 out of every 3 frequent fliers have concerns that the airline or agent will not select the best schedule to satisfy their needs(whether by design or by accident).

It is also noticeable that both the awareness of use of CRS and the desire to know the criteria for flight selection increases with volume of travel: (The heavy travel category being 20+ trips per annum; the medium being 9-19 trips per annum and the light being 1-9 trips per annum). One can assume that the occasional vacation traveller would be less aware of CRS and less concerned about selection criteria than the regular business traveller.

Certain other Survey questions focussed on CRS related issues - the main sources of flight information, the factors influencing airline selection on the respondent's most recent trip and the factors most important generally in choice of airline. What emerges is that North American respondents rank schedule, low fares, frequent flier programs and seating comfort as the principal selection priorities. Of those taking their last trip for business reasons, 50% used travel agents as their principal flight information source (cf 60% of leisure travellers). 10% of the North American sample indicate frequent flier programs are the primary reason for airline choice, 76% of them are members of FFP's and 80% of these acknowledge that FFP's do influence their choice (50% frequently: 32% occasionally).

PASSENGER CHOICE

Passengers have been increasingly faced with more complex choice questions in the deregulated domestic marketplace and are experiencing a similar but less accentuated situation on international routes. More airline, routing, frequency, product and price options are available. With yield/inventory management, targetted advertising and frequent flier awards choice becomes even further complicated. Passengers like the low fares, added frequency, increased availability of airline and destination brought about by deregulation: they are confused by the number and complexity of fares,the continual changes,the subtlety of conditions: they are angered by unrealistic schedules and aircraft changes unanticipated from the flight description - particularly switches to commuter equipment.

It's a viscious circle. Airlines look more and more to CRS to manage their operations, sales, marketing and distribution, they look more and more to agents as the point of customer contact. Agents rely increasingly on CRS to provide the range of information needed -and will do so more in the future as the expanded data bases, enhanced screen display and sophisticated back office support helps them to respond efficiently to the widening range of travel planning questions. The recent DOT decision to order the display of Consumer Protection Information on CRS screens reflects these trends. Passengers look more and more to agents for advice in these circumstances. That advice covers a broader information spectrum than in the past.

Computer generated information to passengers can be influenced through bias in the data base source, or as a result of a special relationship between airline and agent created through reward or penalty. Underlying this is the fundamental role of CRS in accumulation of airline market power, and the resultant impact on passenger choice.

Source Information Bias.

The combination of DOT's periodic efforts to eliminate unfair screen display, "voluntary" action by airlines (eg. to rectify unrealistic connecting times, to eliminate schedule bunching), litigation and Congressional oversight seems to be effective in maintaining relative neutrality in the US. To the extent that new forms of display bias may be injected as technology changes, the checks and balences in the above processes - most particularly the vigilance of carriers displayed in systems should protect passengers from prolonged abuse.

The question of display bias outside the US and corresponding actions against foreign carriers on US screens remains a live issue. Steps are underway in the International Civil Aviation Organization and the European Civil Aviation Conference to develop guidelines to deal with this. It is a key issue for bilateral discussions. International amelioration is however a slow process and the passenger is caught in the middle of the conflicting airline and government interests.

Agent Information Bias

Special relations between agents and airlines can be another cause of manipulated passenger choice. All airlines seek to maximize their sales through agents by means of sales support and commissions, regardless of a linkage through CRS. However, CRS provide market information very efficiently, permit the tailoring of products and prices very scientifically and allow the targetting of incentives very accurately. CRS equipment represents a large item of expenditure for agencies and a commitment in staff training: agencies will be unlikely to invest in more than one system. CRS owners have particular opportunities to exert pressures for sales through the terms and conditions of equipment contracts, performance monitoring schemes, incentive payments - including override commissions, staff training programmes, back office options and support systems. In addition there is the so called "halo effect" whereby the system owner, gets special treatment and additional sales because of his integral involvement in the working of the agency through his CRS support and service.

Agents can always instruct staff to sell the services of one airline over another, regardless of CRS use -that is the essence of override payments. But CRS can facilitate and focus this activity. Back Office reports can provide the targets for agency owners. Screen messages can encourage counterclerks. The enhanced systems can be programmed by agents themselves with a particular sales pitch or to select the services of certain carriers to meet company or personal travel preferences - giving considerable scope for influence should the agent wish it.

We have no evidence to suggest that consumers are generally aware of the special inducements to agents - whether CRS related or not; nor that they are aware of the fact that airlines are the owners of CRS. We suspect that few passengers see any link between CRS, inducement and the range of options they might be presented. The survey response referred to above, suggests that many passengers are aware of the existance of CRS but gives no clue as to knowledge about ownership. Airlines do not advertise ownership of systems to the public at large although they do to the travel trade. There is no reason for this information to be passed on and to the extent that there are special CRS related inducements it is not in the agents' interest to educate the passenger. Articles in the trade press suggest that corporate travel managers are aware of the implications of both CRS ownership and related inducements: but this group are not representative of passengers generally and in many cases they too may be part of the inducement network.

It seems significant that two thirds of the survey respondents prefer to make final choices as to itinerary and airline themselves. No doubt a percentage of these are questioning whether airlines and agents are providing the best options. For others, this may simply be to check if they can take full advantage of frequent flier programs or simply because they want to make the final decision themselves. In addition there are the substantial number of passengers who are unaware of the role of CRS and there are those who are happy to leave matters to the airline or agent: the unaware and the trusting are particularly vulnerable in the event of abuse.

REMEDIES FOR ABUSE.

In principle, consumer interests are best met by competitive air transport and CRS operations, agents who have high incentives to meet client needs and passengers who are reasonably able to make informed choices. Are these conditions being met today? Are there enough checks and balences to prevent serious or lasting market distortion? Can deficiencies be met by regulatory adjustment or is some fundamental change necessary, such as divestiture by system owners.

On the one hand, the U.S. airline industry is becoming more concentrated as a result of mergers. CRS has reputedly been an important factor in certain cases; eg. to acquire a system (Texas Air/Eastern), to participate in a system (Western/Delta). The major airlines are carrying a larger share of total traffic and a small number of carriers are currently earning a lion's share of profits.There is no doubt that CRS owners have a tool which dramatically enhances competitive ability and revenue.

Furthermore, in specific hubs there may well be market dominance and entry barriers, underpinned by CRS saturation of local agency outlets. In such markets where one or two carriers have hub control it is evident that agents will be issuing the majority of tickets on their services and almost inevitable that the agents will use the CRS of one of those carriers. Michael Levine has cogently identified the links between hub presence, gate and slot control,tariff structures, frequent flier programmes, agency ties and CRS ownership in an article in the spring/87 Yale Journal of Regulation. A powerful CRS is seen as the key tool for increasing scale and scope of market power; it provides both the opportunity and the means for influencing agent sales - which the non owner is unable to match.

On the other hand, the degree of general concentration does not seem to have increased enormously in the past 10 years, in terms of carrier numbers, traffic share and revenue. The number of competitors while decreasing and consolidating do not yet seem to be out of line when compared to other industries. Moreover in the past five years CRS ownership has become more diverse, competition has intensified and the battle to change and free up agency ties has hotted up. SYSTEM ONE has become a serious challenger to SABRE and APOLLO in many markets. Northwest has become a partner in PARS. Allegis is offering to sell a substantial interest in COVIA (APOLLO). Non airline systems while not yet serious competitors, continue to be developed.

International CRS combines add a new element to the competitive picture. Major CRS ventures have recently been established in other parts of the world owned by foreign airlines (with US carrier interests). GALILEO (British Airways, KLM, Swissair, Alitalia, COVIA et al) and AMADEUS (Air France, Lufthansa, SAS, Iberia et al with Texas Air) in Europe, ABACUS (Singapore, Cathay, Thai) in Asia. Similar concepts are under consideration elsewhere. They intend to operate in all markets including the U.S. As US CRS Systems and US carriers expand their scope, the foreign systems will seek corresponding opportunities in the US marketplace.

Given these competition trends, the fact that the dynamics of the deregulated market are constantly changing and the enormous technological developments underway in the CRS field, it seems premature to assume that divestiture will necessarily provide the best solution for consumers. Examination is needed of the claims of synergism between air transport operations and CRS investment/development patterns. Some airlines who have invested shrewdly in CRS could be penalized severely, to the advantage of competitors who chose to make their investments elsewhere and foreign carriers who will be under no such strictures. Divestiture, nevertheless, is a comparatively clearcut way to change the competitive forces at play including the basis of agency relationships. To this extent it cannot be discarded as an option if current quasi regulatory corrective approaches fail to prevent serious market abuse.

There is no denying that attempts are being made to maintain fair competition under the current regime. Since enactment of the 1984 CAB rules, the target of complaint, investigation, regulatory action, legislation and litigation, has moved from access to systems and display bias, to agency control and market access for systems. Today there is pending legislation on booking fees, liquidated damage levels, equipment charges, contractual changes and arbitration. There is the ongoing DOT investigation covering similar issues and focussing on incremental revenue and market power. There are new antitrust cases with system owners claiming and counter claiming anticompetitive CRS related sales tactics with agents.

As with any activity involving regulation, there is a time lag from initiation to identification of abuse and then to the resolution of the problem. During such period passengers suffer from the absence of proper market information and carriers are faced with unfair competition. CRS Rules need periodic review and updating to keep pace with carriers trying to get a sharp competitive edge. The DOT must be prepared to take fast corrective action, including fines at high enough levels to have a real deterrent effect. The DOJ, the Courts and the Congress clearly have important roles in preserving competitive checks and balences. Specific action may be needed to ensure competition at dominated hubs. But in these respects air transport need be treated no differently from other industries where questions of market concentration arise.

One area which appears to have been largely ignored as a means to correct market distortion is through more accurate consumer information on airline/agency ties.In our view, most passengers are inclined to look at Travel Agents as their travel advisor rather than an airline's distributor - an image helped by carrier advertising..."Call your local agent for details of discounts etc". The Australian Trade Practices Commission has described the relationship as "the de facto agent of the passenger and the de jure agent of the airline". Regardless of the legal nicities, a passenger has every reason to believe agents are acting on his or her behalf, providing information which optimizes customer choice and which is neutral with respect to airline or other service provider. This is implicit in the prominently displayed industry signs showing participation in ARC or IATAN programmes and the stickers of dozens rather than a single airline. It is explicit in the original CAB rules and subsequent DOT revisions seeking neutrality of display in travel agents' offices.

We believe there would now be considerable merit in public disclosure of CRS systems used by agents and of the existence of override commissions from specific airlines, coupled with an education programme to alert passengers to the implications. This does not imply any attempt to regulate commission practices or levels - it would simply put passengers on notice that dealing with a particular agent gives a high likelihood of special arrangements with a particular airline. The passenger would be free to ignore this information, to question the agent further, or ask for alternative options. In other words the principle of "caveat emptor" would be meaningful because the buyer would begin to have some indication of what he should beware. Some agents and airlines may seek to market their relationships, once a climate of open information has been established, offering for example bonus frequent flier points to loyal clients. In other words behave like suppliers and distributors in other industries.

Such a scheme would require for example registration of the existence (but not the amounts) of overrides with DOT and a procedure for checking that consumers were given the right information. There would be no requirement on agents to volunteer information - rather the burden could be on passengers to ask the necessary questions. A complimentary passenger education programme could be easily established.

Finally, these comments have focussed on the U.S. domestic marketplace but the international implications of US developments are of increasing importance, given the key role of CRS in the global marketing, sale and operation of air transport services and the accelerating international spread of Systems. The International marketplace has traditionally been characterized by dominant national carrier CRS influence, closely tied agents and protective sales procedures. Here too we believe that the best form of protection of consumer interests is genuine fair competition between systems coupled with international procedures akin to the DOT rules and an informed consumer (see Appendix A). The US and other States should be vigorously pursuing this goal through bilateral agreements and multilateral Codes of Conduct.

ATTACHMENT 'A'

November 1987

IFAPA POSITION ON

COMPUTERIZED RESERVATION SYSTEMS (CRS)

International airline tickets and related services are increasingly marketed and sold through computer systems. The majority of travellers will purchase tickets from travel agents (or other distributors using CRS) and will rely directly or indirectly on information provided by such systems. This is good for airlines, agents and the public to the extent that it reduces costs, increases efficiency and optimizes choice.

What passengers need from the airline sales distribution systems are good information on travel options, an indication of the best value deals and ease of confirming arrangements.

Passengers can benefit from such developments as multi-million dollar enhancements to the major computer reservation systems, initiatives to develop new competing systems, regional cooperation between airlines to improve systems and linking of systems to provide better services. Healthy and fair competition must be sought in the CRS industry to ensure efficiency and neutrality. At the same time the entrepreneurial spirit which produces innovations which benefit consumers should be encouraged.

Passengers will not benefit from practices which limit carrier access to CRS or related sales networks, which prevent the establishment of systems in specific markets, which distort the objectivity of information presented via CRS including display bias, which unreasonably tie travel agents to specific systems or which establish exorbitant user fees. Consumer choice is limited by these practices, and costs of services are increased.

Any regulation of computer reservation systems should be designed to encourage a spread of such systems and should be the minimum necessary to achieve fair conditions of operation and competition. IFAPA welcomes initiatives by governments and the industry to establish rules of fair play for computer reservation systems and will seek to ensure that passenger interests are given a high priority in such initiatives.

.../...

In this context, IFAPA supports government action to develop codes of conduct governing CRS use. It believes moreover that industry organizations of airlines and travel agents should promulgate a passenger-friendly code signifying their members' commitment to fair play, fair display and open dealings with CRS.

Such codes should start from the assumption that CRS should be used to facilitate rather than influence passenger choice and might include:

- Prohibition against unfair, discriminatory or predatory practices by CRS operators to the detriment of competition in the CRS market;
- Equal access to systems, telecommunication links, agency networks, settlement plans, etc., for airline users on a national treatment basis - including a right of reciprocal access;
- Fair display on the basis of clear, comprehensive published criteria;
- Non-discriminatory, reasonably priced charges for airline users;
- Balanced agency contracts of equitable duration and reasonable liquidated damage clauses;
- Public information on agency/vendor links and commitment to accurate description of flights, services and tariffs.

IFAPA believes that passengers should also be educated as to the potential benefits that CRS offer, so that they are in a position where their own knowledge and habits can help to extract the optimum information. IFAPA would encourage airlines to advertise the capabilities and advantages of their CRS and would also encourage agents to be prepared to reveal the systems they are using and the main criteria taken into account when recommending itineraries.

-0-